# Annual Report 2018

البنك الوطني العماني

NBO

**His Majesty Sultan Qaboos bin Said**

# Contents

Chairperson's Report 2018

# "Throughout 2018, we have strengthened our position as the "Bank of Choice" in Oman across all key banking segments, by delivering compelling solutions, innovative products, and world-class service."

Rawan bint Ahmed Al Said
Chairperson

Chairperson's Report 2018

# Dear Shareholder,

On behalf of the Board of Directors of National Bank of Oman SAOG (NBO), I am pleased to announce the Bank's full-year results for 2018.

## Economic developments

The year started on a cautious note, given the persistently low oil prices. However, as oil prices recovered during the year, Oman's economy began to pick up. Coupled with the Government's continued focus on diversification, this resulted in a lower than budgeted deficit and the first signs of green shoots of recovery.

Most analysts predicted growth of 3 percent in 2019 and 2.5 per cent in 2020. Moody's forecast expects Oman's real GDP to grow between 2 to 3 per cent over the next three years. Even though oil prices averaged higher in 2018, some recent forecasts are less positive, with rating downgrades on the sovereign and the Bank.

Nevertheless, there is cautious optimism across numerous sectors of the economy. This is reflected in Oman's national budget for 2019, which aims to allocate sufficient funds for key development projects and to increase the share of non-oil revenues in future. The budget also focuses on attracting investment through public private partnerships and helping more SMEs to win Government assignments. The Central Bank of Oman played a key role in stimulating the economy during the year through various regulatory measures primarily affecting liquidity, funding and capital ratios.

The banking sector, however, has continued to face a challenging market. The liquidity position has not eased to the desired extent and asset quality pressures persist, especially in the real estate sector. Credit growth in Oman in the first 10 months has been 5.7 per cent, while deposits growth was 4.4 per cent.

**9.6%**

**Return on Equity**

**15%**

**Net Profit Growth**

## Operating performance

Against this backdrop, NBO reported 15 per cent growth in net profits compared to last year, primarily as a result of lower provisioning from the UAE. As reported in prior commentaries, the Bank has proactively exited most of its non-strategic UAE customers over the past 18 months, as we seek to concentrate on relationships emanating from Oman. The decline in UAE net loans in the last six quarters was OMR 93 million, leading to a significant decline in total operating income during 2018.

Now, with our UAE operations stabilized, we expect a gradual improvement from Q1 2019. Going forward, our focus will be on the substantial trade opportunities between Oman and UAE, and on strengthening our existing relationships. As a result, we expect the UAE drag to continue to diminish, contributing to a stronger performance for the Bank as a whole.

In Oman, where most of our operations lie, the performance was very satisfactory: a 3.6 per cent growth in operating profit and an impressive 14.80 per cent growth in net profit. This is due largely to a significant increase in fee income and better cost management. Funding costs have risen sharply from 1.97 per cent in 2017 to 2.32 per cent in 2018. Despite our strong franchise in Oman and therefore our ability to mobilize low cost deposits, net spreads reduced by 20 bps.

## Prioritizing profitability

Our short-to-medium term focus remains on growing our margins, with a modest growth in loan book size and continued fee income diversification. The latter in particular has gained momentum during 2018, while ongoing cost management initiatives have kept cost growth to a minimum. Cost management will continue to be a relentless focus in 2019, although there is ample investment approved for digitization and transformation initiatives.

Impairments on loans and advances for the year were at OMR 7.4 million. This is a reduction of 54.8 per cent over the same period last year, due largely to lower levels of provisioning in the UAE and higher recoveries. We continue to be vigilant in monitoring the loans portfolio for both Oman and the UAE.

IFRS 9 was also successfully implemented during 2018. The Bank is satisfied with the stringent staging criteria and the expected credit loss appears conservative compared to peers in Oman and elsewhere in the GCC.

Net loans and advances as at December 2018 were OMR 2.8 billion, an increase of 5.9 per cent on last year, with most of the growth occurring at the end of Q4. Customer deposits as at December 2018 were OMR 2.45 billion, with a healthy cost-to-total-liabilities ratio of 59.5 per cent.

In September, we concluded a very successful EMTN issuance of US$500 million to European, Far East and Middle East investors. The issuance was over-subscribed by more than two times, clearly demonstrating the confidence investors have in our strategy, implementation and performance in this difficult market environment. The Board and the management team are greatly encouraged by this.

The capital adequacy ratio as at December 2018 stood at 16.3 per cent, against the regulatory requirement of 13.5 per cent, reflecting the Bank's very robust capital position.

The Board has recommended dividends at levels commensurate with the strong capital ratios throughout the cycle. These are, of course, subject to regulatory approvals.

## Oman's preferred bank

As the first bank established in the Sultanate, we understand the great responsibility we have towards our customers, employees, shareholders, and the community we operate in. Throughout 2018, we have strengthened our position as the "Bank of Choice" in Oman across all key banking segments, by delivering compelling solutions, innovative products, and world-class service.

Time and time again, we have set new standards in the industry with our products, our services and our customer-first approach. Notable achievements in 2018 included the launch of the Badeel prepaid card, one of the first in Oman to incorporate "tap and go" contactless technology.

Our award-winning mobile app has improved further this year with more upgrades, new features and additional ways for customers to bank electronically. Similarly, upgrades to our online banking platform ensure it is easier and more convenient than ever for both corporate and personal customers to keep on top of their finances.

We ended 2018 with the largest ever prizes in our revamped Al Kanz Mega Draw, which is proving to be a powerful tool to motivate customers to build their wealth through savings, while our "Tijarati" SME speaker series is helping to facilitate invaluable knowledge transfer and growth amount Oman's budding entrepreneurs.

In a further demonstration of our support for Oman and all its citizens, our corporate social responsibility initiatives invested almost OMR 324,000 in numerous programs, making a difference to communities across the country.

## Building powerful partnerships

We also strengthened our long-lasting relationships with a number of private and public sector organizations. We partnered with Oman National Engineering & Investment Company to provide a simple, seamless way for businesses to make their monthly payments to the Public Authority for Social Insurance, and we enhanced our relationships with several blue-chip clients, including the Royal Opera House Muscat, Etihad Airways and Axis Bank, one of India's largest private sector banks.

As the first Islamic banking platform in Oman, Muzn Islamic Banking achieved satisfactory growth in both assets and earnings and further enhanced its privileged banking services to meet the banking, investment and lifestyle needs of high income customers.

**Our corporate social responsibility initiatives invested almost OMR 324,000 in numerous programs, making a difference to communities across the country.**

## Looking ahead

As we look forward to 2019, we are committed to leading the market by consistently demonstrating our customer-first approach, superior service, innovative technology and diverse range of products and services.

Our goal is to be the best bank for our customers, employees, shareholders and community. I'd like to thank the more than 1,500 NBO team members who are a vital part of this journey. Together, we are building a better bank. I look forward to continuing our work together to ensure NBO achieves its full potential over the months and years ahead.

On behalf of the whole NBO team, we thank our customers, shareholders, regulators, partners and wider community for their continuing support throughout the year. Above all, we pay tribute to His Majesty, Sultan Qaboos bin Said, for his inspiring leadership, vision and wise guidance, which continues to propel Oman towards success.

NBO is committed to pushing the boundaries of innovation, finding inspiration in the most unexpected places, and providing all those who rely on us with the best we have to offer. It is my honor and privilege to be part of an institution that is helping to drive Oman's growth and development.

**We pay tribute to His Majesty, Sultan Qaboos bin Said, for his inspiring leadership, vision and wise guidance, which continues to propel Oman towards success.**





**We are committed to pushing the boundaries of innovation, finding inspiration in the most unexpected places, and providing all those who rely on us with the best we have to offer.**

# Board Members' Profiles

## Sayyida Rawan Ahmed Al Said, Chairperson

**Member of the Executive, Nomination and Remuneration Committee (ENRC)**

Sayyida Dr. Rawan Ahmed Al Said is the CEO of Takaful Oman SAOG, Prior to joining Takaful Oman, she was the Managing Director and CEO of ONIC Holding Corporation. Before moving to the Private Sector, Rawan was the Deputy CEO-Investment for the State General Reserve Fund of Oman, leading the execution of many mega investments internationally. She has almost 30 years of experience in the financial industry, 20 of which are in the Public sector. Sayyida Rawan remains to be the First and the only Female who holds a CEO position in a public listed company in Oman.

She has been a member on the Board of a number of reputed Companies and Financial Institutions in Public and private sector in Oman and the GCC region. Chairperson in National Bank of Oman, Deputy Chairperson in Oman Oil Marketing Company, Board Member of Oman National Investments Development Company ONIDCO (Tanmia) and Chairperson of its equity and GCC funds committee. In the public sector, she was on the board of Oman Oil Company SOAC and its audit committee. She was on the Board Member of International General Insurance (IGI) Jordan, and National Finance House (NFH), Bahrain. Deputy Chairperson of Orix Finance, National Life & General Insurance Company SAOC (NLIG) and Al Ahlia Insurance.

She is also a Member on the Investment Committee of the Public Authority for Social Insurance, Board Member in Public Authority for the SME Development (Riyada). Chairperson of Al Kawther Fund (Islamic Compliant Fund) and a Member of the Investment Committee of Orphans & Incapacitated Funds in the Ministry of Justice. She has been recently appointed as a Board member of the Sultan Qaboos University Council.

**Awards and Recognition**

In 2011, She was bestowed the Business Professional (BizPro) Leader Award. In 2012, was ranked 14th in Forbes Middle East for the 'Most Powerful Arab Business Women in Listed Companies'. In 2014, Rawan was named among the Best Chief Executives in the region by Trend in collaboration with INSEAD (The Business School for the World). Also she was Awarded Hall of Fame by MARA Excellence Awards. In 2015, she was honored with two prestigious Awards; Asian Women Leadership of the Year from World Leadership Congress and in MENA and Business Leader of the year from the Middle East Accountancy and Finance Excellency Awards 2015.

Sayyida Dr. Rawan, has an MSc in Economics & Finance from Loughborough University UK. She also holds a Post Graduate Diploma in Investment Analysis from Stirling University UK, and BA in Economics & Political Science from the American University in Cairo (AUC).

In 2016 she was honored with Honorary Doctorate Degree from Commonwealth University in UK and she was awarded as the Best Takaful CEO from Global Business Outlook, UK. Dr. Rawan ranked 3rd in Oman for Forbes the Top 100 most powerful Arab Businesswomen 2017. In 2017 and 2018 she won the best CEO-Oman award from International Finance UK and she won Oman Women of the year awards 2018 for the inspirational woman category.

Board Members' Profiles

## H.E. Sheikh Abdulla Bin Ali Bin Jabor Al Thani, Deputy Chairman

**Member of the Executive, Nomination and Remuneration Committee (ENRC)**

H.E. Sheikh Abdulla bin Ali bin Jabor Al Thani has been a Director of the Bank since July 2005 and serves as a member of the Board Executive, Nomination and Remuneration Committee (ENRC). His Excellency is the Chairman of The Commercial Bank (P.S.Q.C.) in Qatar, a member of the Board of Directors for United Arab Bank, P.J.S.C. in UAE and is the Owner of Vista Trading Company (Qatar), and a Partner in Integrated Intelligence Services Company (Qatar).

H.E. Sheikh Abdulla bin Ali bin Jabor Al Thani holds a Bachelor of Arts Degree in Social Science from Qatar University.

## Ms. Amal Suhail Bahwan, Director

**Member of the Executive, Nomination and Remuneration Committee (ENRC) and the Board Risk Committee (BRC)**

Ms. Amal Suhail Bahwan is the Vice Chairperson of Suhail Bahwan Group Holding LLC. She has extensive experience in managing companies across the Bahwan Group.

She is also the Chairperson and Executive Committee member of Al Jazeera Steel Products Co. SAOG. and Director and Board Remuneration Committee member of Oman Oil Marketing Co. SAOG.

Ms. Amal has a Bachelor's degree in Education and a Master's degree in Administration from the Sultan Qaboos University.

## Mr. Hamad Mohammad Hamood Al Wahaibi, Director

**Chairperson of the Credit Committee of the Board (CCB) and member of the Board Executive, Nomination and Remuneration Committee (ENRC)**

Mr. Hamad Mohammad Al Wahaibi has been a Director of the Bank since March 2014. He has 20 years of experience in the GCC. He has been a director of investment with the Ministry of Defense Pension Fund for the past six years. Mr. Al Wahaibi is also a member of the boards of Voltamp Energy Company and ACWA Power Company.

Mr. Al Wahaibi holds a Masters of Business Administration (MBA) degree, specializing in Finance, and he is a Chartered Financial Analyst (CFA) charter holder, Chartered Alternative Investment Analyst (CAIA) charter holder, as well as a Certificate in Investment Performance Measurement (CIPM) Certificant.

## Mr. Mohammed Ismail Mandani Al Emadi, Director

**Chairperson of the Board Risk Committee (BRC) and Member of the Board Audit Committee (BAC)**

Mr. Mohammed Ismail Mandani Al Emadi has been a Director of the Bank since November 2014. He is also a member of the Board for The Commercial Bank (P.S.Q.C.) and a member of the Board of Alternatifbank A.S. (ABank), Turkey and has over 30 years of banking experience. Mr. Al Emadi has held a number of key roles at Commercial Bank until 2006, after which he served as Chief Executive Officer of Qatar Real Estate Investment Company Q.S.C. up to 2011, and also served as its Director from 2003 until 2005.

Mr. Al Emadi holds a Bachelor of Arts Degree in Business Administration and Economics from Holy Names University, California.





## Mr. Fahad Badar, Director

**Member of the Credit Committee of the Board (CCB and the Board Risk Committee of the Board (BRC)**

Mr. Fahad Badar has been a Director of the Bank since May 2016. He is also a member of the Board for United Arab Bank, P.J.S.C. in UAE since July 2016.

Mr. Badar's career at The Commercial Bank (P.S.Q.C.) in Qatar spans over 19 years. Prior to his current role as Executive General Manager, International Banking, he held a number of key roles in International Banking, the Government and Public Sector Relations and the Wholesale Banking Divisions.

Mr. Badar holds an MBA from Durham University, UK and a Bachelor of Arts Degree in Banking & Finance from the University of Wales.

## Mr. Rahul Kar, Director

**Chairperson of the Board Audit Committee (BAC)**

Mr. Rahul Kar has been a Director of the Bank since April 2016. Mr. Kar is a Chartered Accountant and is currently working as the Financial Advisor to the Chairman of Suhail Bahwan Group Holding LLC.

Mr. Kar is also a Director and an Audit committee member of Al Jazeera Steel Products Co. SAOG. He is also a Director and Nomination & Remuneration committee member of Oman United Insurance Company SAOG.

## Mr. Ghassan Khamis Al Hashar, Director

**Member of the Board Audit Committee (BAC) and the Board Risk Committee (BRC)**

Mr. Al Hashar joined NBO Board as a representative of the Public Authority for Social Insurance (PASI) in March 2017. He is currently the Authority's Director of Investments. He has over 20 years of experience in finance and investment management, and represents PASI on the boards of numerous public and private companies. He is also a Board Director at National Life & General Insurance Company SAOG and Oman National Investments Development Company SAOC (TANMIA).

Mr. Al Hashar holds a Master's Degree in Finance and Investment Management.

## Mrs. Najat Ali Al Lawatia, Director

**Member of Credit Committee of the Board (CCB)**

Ms. Najat Ali Al Lawatia was elected as a Director of the Bank at the AGM in March 2017. She holds a Commerce Bachelor Degree in accounting and has attended various courses in diverse fields of financial management, audit, investments etc. She is working as the Deputy Director General for Support Services with Civil Service Employees Pension Fund and has more than 20 years of relevant experience.

Ms. Najat is also a Director and Chairperson of Audit Committee of Oman Cement Company SAOG.





## Mr. Rashid Bin Saif Al-Saadi, Director

**Member of the Board Audit Committee (BAC) and a member of the Credit Committee of the Board (CCB)**

Sheikh Rashid has been a member of the Board of Directors since August 2017, and is a renowned financial and investment banker, business executive, entrepreneur and philanthropist. Sheikh Rashid is also the CEO of TANMIA, a company that actively contributes to the Sultanate's economic development.

Sheikh Rashid holds a B.Sc. in Business Administration from Rollins College, USA. His career is marked by many significant achievements and milestones; including a twelve year stint with the Diwan of Royal Court.

In 2000, Sheikh Rashid was appointed CEO of TANMIA, which was setting up its Investment Fund with the Muscat Securities Market at the time. Following his appointment, the Board of Directors decided to transfer the responsibilities of managing the fund to the company directly, and two new Funds were set up subsequently; a Private Equity Fund, the GCC Investment Fund, and the Shari'a Fund in 2013. In addition, Sheikh Rashid also drove direct investments into various industries, including and not limited to Real Estate Development; the company played an active role in the development of the Al Mouj Muscat Project, and in the Tourism sector, the company played a key role in setting up the Kempinski Hotel, Muscat. In the Industrial Sector the company contributed to the establishment of Octal Petrochemicals, also extending into the retail sector by partnering with Al Meera Group to set up its business in the Sultanate.

In addition to his executive responsibilities, Sheikh Rashid is the Chairman of Board of Directors of Takaful Oman SAOG and A'saffa Foods SAOG. He is also a Director on the Boards of Oman National Finance Co. SAOG, Minerals Development Company SAOC, Muscat National Development and Investment SAOC, Almouj Muscat & Oman Hospitality Company.

## Mr. Joseph Abraham, Director

**Member of the Executive, Nomination and Remuneration Committee (ENRC)**

Mr. Abraham was appointed as a Board Member of NBO in May 2018.

Mr. Abraham is the Group Chief Executive Officer of The Commercial Bank as well as Vice-Chairman of the Board of Directors of Alternatif Bank and a Board Director of the United Arab Bank, UAE. He has extensive banking experience across both developed and emerging markets. Before joining The Commercial Bank in June 2016, he was CEO of ANZ Indonesia (Australia and New Zealand Banking Group) based in Jakarta, a position he served in from 2008 to 2016. Mr. Abraham has an MBA from the Graduate School of Business, Stanford University, California and has worked in Indonesia, Singapore, Hong Kong, Ghana, UK and India in various country and regional banking roles with a successful track record covering general management, corporate banking, strategy, product management as well as acquisitions and integrations. Mr. Abraham was appointed as a Board Member of Alternatif Bank in December 2016.

Executive Management

**Nasser Mohammed Al Hajri**
GM - Chief Operating Officer

**John Chang**
GM – Chief Retail Banking Officer

**Faizal Mohamed Eledath**
GM - Chief Transformation Officer

**Hassan Abdul Amir Shaban**
GM - Chief Government Banking Officer

**Al Sayyid Wasfi Jamshid Al Said**
Acting Chief Executive Officer

**Ananthraman Venkat**
GM - Chief Financial Officer

**Salma Salim Said Al Jaaidi**
GM - Chief Risk Officer

**Nasser Salim Al Rashdi**
GM – Chief Commercial Banking Officer

Our Vision

## Our Vision

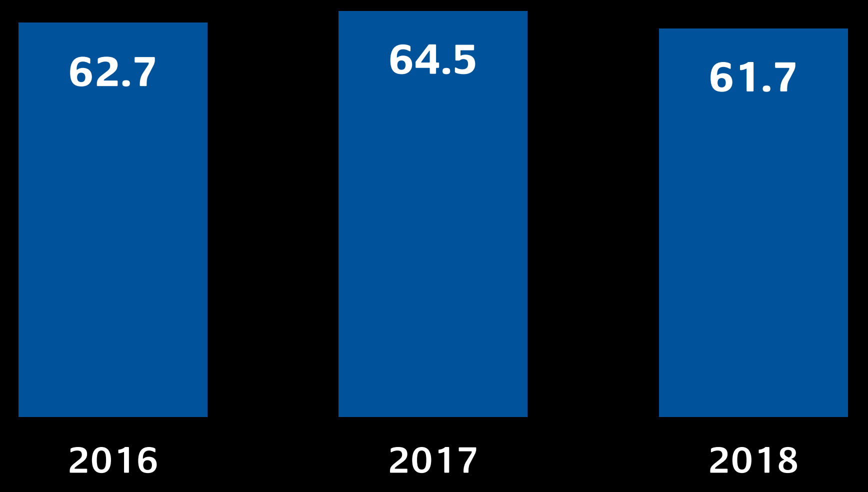
# To be The Bank of Choice

# Management Discussion and Analysis Report 2018

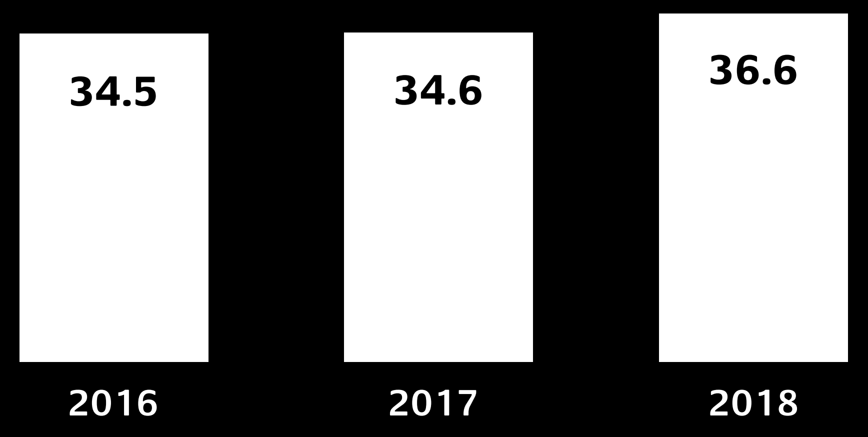
# Financial Highlights

**50.6** Net profit up by 15%

## Optimized and efficient cost management (OMR Million)



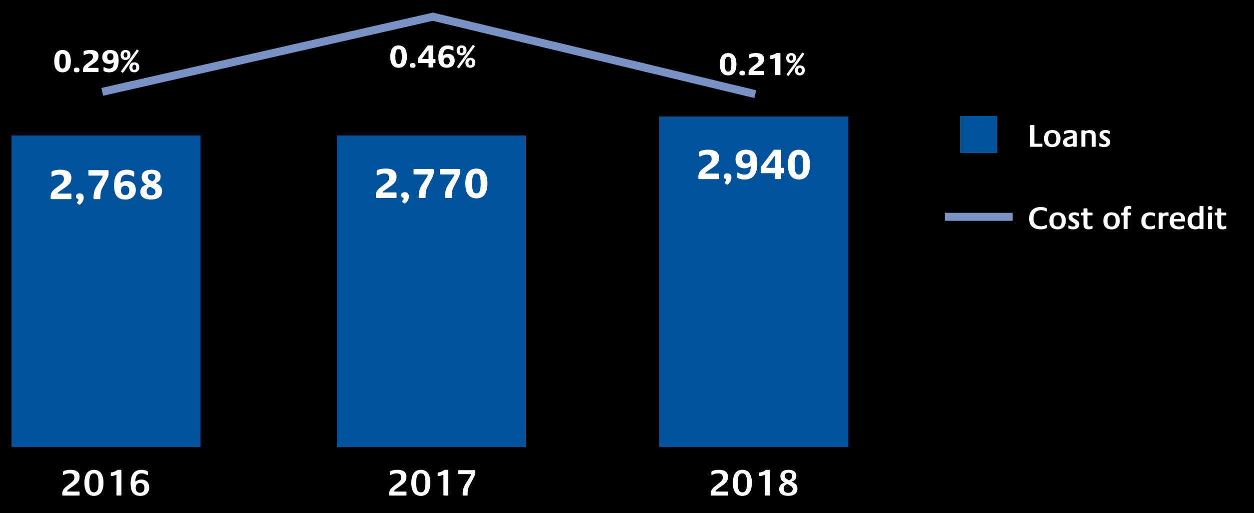

## Diversified and sustainable fee income (OMR Million)



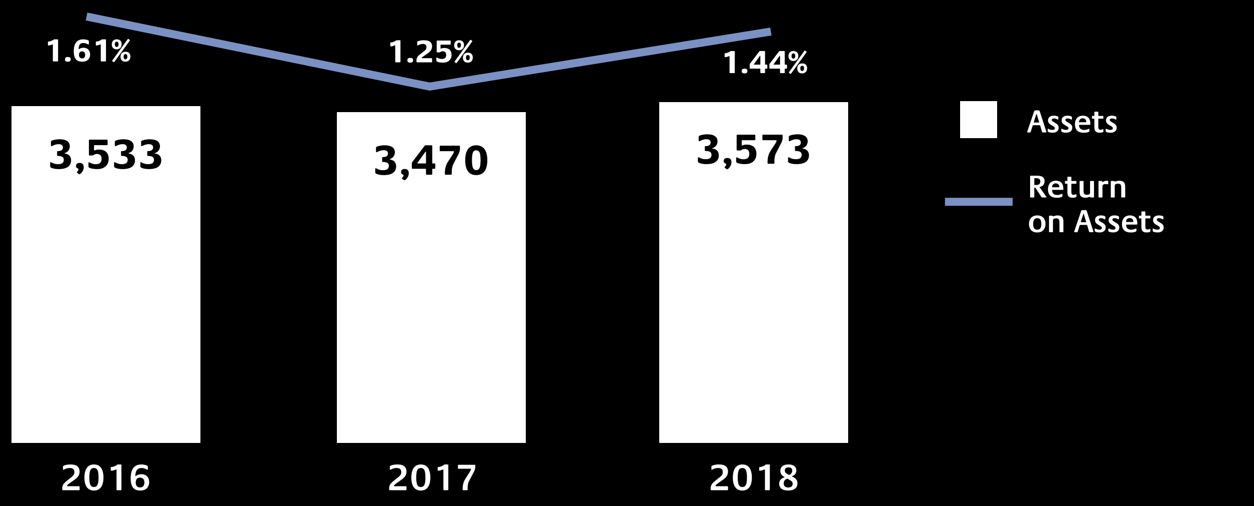




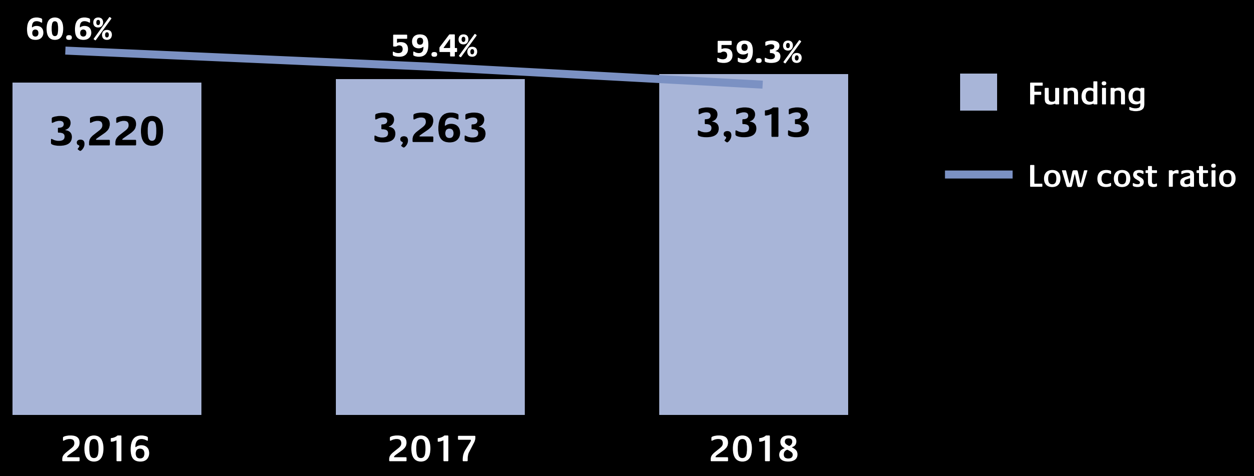

## A growing diversified portfolio (OMR Million)




## Stable revenue generation (OMR Million)




## Stable funding (OMR Million)



Management Discussion and Analysis Report 2018

# Our strategy positions the Bank to provide customers a vastly superior experience and deliver sustained profitable returns

Al Sayyid Wasfi Jamshid Al Said
Acting Chief Executive Officer

## Building a bank fit for the future

Our performance in 2018 was one that everyone at NBO can be justifiably proud of. NBO is now more profitable, more stable and more secure than it was in 2017. Our impressive financial results are a tangible demonstration that our forward-looking corporate strategy is leading us in the right direction. We have been agile in adapting to changes in the macro-economic environment and responding to regional challenges, and we have successfully repositioned NBO for its next wave of growth.

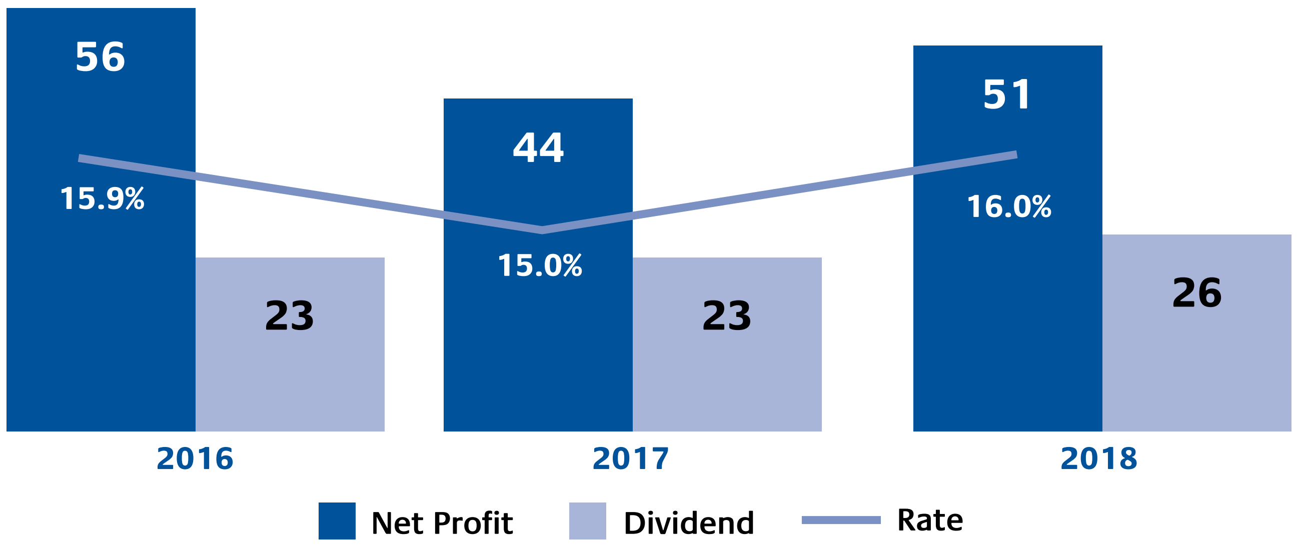
Financially, we demonstrated our strong recovery over the past 12 months, with the brightest results we have achieved for several years. We enjoyed a 15 per cent growth in net profits compared to 2017, reaching RO. 50.6 million, and our capitalization metrics are very solid.

Our network of more than 60 branches in key strategic locations, plus our award-winning landmark headquarters on a prime site in Muscat's commercial district, ensure our footprint and our profile are stronger today than they have ever been. We are rightly regarded as the 'national' bank and our brand conveys a sense of stability, credibility and respect that none of our peers can match.

The recognition of NBO as a strong and stable bank was clearly demonstrated by our US$500 million note issuance in September 2018, which was over-subscribed by almost 2.5 times by institutions from the world's leading financial centers. This helped us to broaden our base of investors and incorporate a wider and more diversified geographic reach than previous note issues. It was also a sign of our growing global reputation as a safe investment that is helping to further drive Oman's development.

## Consistent shareholder value delivery

With the consistent growth in Cash dividend year on year with the dividend payout ratio of 40%-50%, NBO is one of the reliable dividend yielding stock in the MSM index.




This has enabled NBO to underline its reputation as a bank that consistently delivers on shareholder value and continually returns attractive dividends to our shareholders.

As Oman's first local bank – established in 1973 to support the country's development – we benefit from a special position in the market and a unique platform to reach investors, business and trade partners. Our focus is on building a brighter future for Oman to help its people prosper, both within the Sultanate and beyond its borders. We have grown together and are now empowering the next generation of Omanis to thrive and achieve their potential in a rapidly changing world.

## Sustainable strategy

The repositioning of our business is in line with our forward-looking strategy to focus on profitable and selective growth which is sustainable for the long term and cement our position as the 'bank of choice' in Oman.

This means we have not been as exposed to ongoing weaknesses in sectors like real estate, construction and contracting. Instead, we have put in place the building blocks of a more sustainable, future-facing growth model, based on fee income diversification, a relentless focus on our customers' needs, and careful cost management.





## Income diversification

Our commitment to investing for the longer term is a fundamental pillar of our income diversification strategy. Rather than relying on fund based income, we made a strategic decision to strengthen other, less risky, revenue streams. The seeds we planted in the last couple of years to enhance our non-interest fee income have started to yield very positively in 2018.

In particular, we focused on areas like wealth management, significantly increasing the number of certified wealth advisors at the bank and successfully growing our investment income, while providing our clients with an enhanced return on their investments year-on-year. Through our revamped Sadara banking proposition, our top-tier clients can turn to us for the full range of investment advice, wealth management services, and private banking needs, taking advantage of our new partnership with a Swiss private bank.

We also further enhanced the privileged banking services of our Muzn Islamic Banking proposition, the first Islamic banking platform in Oman. This helped to deliver satisfactory growth in assets and earnings, as an increasing number of high income customers turn to Muzn for their Islamic banking, investment and lifestyle needs.

Our corporate banking business achieved outstanding growth in 2018. We achieved an 9.8 per cent increase in operating profit, including 12.8 per cent growth in assets.

**Our 2018 note issuance was over-subscribed by almost 2.5%**

At the start of the year we identified our priority targets – solid names and robust transactions - and we dedicated significant time and effort to securing them, with great success. We have been very successful in showing the market what we have to offer and why we are a good partner.

The team was busy all year working on the right kind of deals, developing these relationships and nurturing the opportunities. It was immensely satisfying to see many of them come to fruition in the last quarter, with decent pricing, good structuring and some high-quality names, including three large restructurings in syndication with other banks.

The structuring and advisory fee income has also increased significantly, as has our Financial Institutions Group, which achieved 9 per cent growth in profits,

**17%** Increase in card numbers

**50%** Increase in card-based retail transactions

both contributing substantially to our diversified income streams.

We have also substantially expanded our point-of-sale (POS) business and are the fastest growing merchant acquirer in Oman, with a 28 per cent increase in POS clients delivering a 44 per cent increase in POS fee income on 2017. Our bancassurance business, too, has grown in strategic importance, driven by a strengthening of our relationships with alliance partners. Thanks to continued investment in training, quality control and sales initiatives, we successfully increased bancassurance revenues by 4 per cent year on year.

Meanwhile, the launch of our Badeel prepaid cards during Q4 added further impetus to the growth of our card business in general. We achieved a 17 per cent increase in card numbers compared to 2017, and the total number of card-based retail banking transactions increased from 37 per cent to 50 per cent.

## Focusing on customer needs

The move away from cash evidenced by these figures is underpinned by the continued development of our digital channels to ensure the best user experience for customers. To be truly digital means going beyond front-end customer interfaces, such as digital apps or mobile and internet banking, to also focus on back-end processes and efficiency. NBO has spent several years re-architecting our technology infrastructure to build a resilient and scalable eco-system to further support our ambition to deliver products and services that redefine superior customer experience.

Our digitalization strategy has been instrumental in helping us create new income streams and gain market share. Our mobile banking app is not only reliable and

**We have made it simple and easy for our customers to engage with us digitally.**

Management Discussion and Analysis Report 2018

secure, its usability and design are exceptional – as shown by the fact it now enjoys the market's highest percentage of registered users as a proportion of the total active customer base. It is also one of the main reasons that we already have twice as many digital retail banking transactions per month as we do in branch. We make it simple and easy for customers to engage with us digitally. Coupled with our focus on agile methodologies and our understanding of the whole customer journey, we have been able to improve speed to market and elevate customer experience. This not only translates to more digitally-engaged customers, but also to higher returns per customer.

One example is our non-resident proposition, where we launched a one-click remittance facility in partnership with Axis Bank, one of India's largest private sector banks. The successful implementation of this facility is a direct result of our unwavering pursuit of, and commitment to, superior customer service and has significantly increased our fee income from non-resident remittances.

At the same time, by enhancing and developing our digital infrastructure and IT systems, we have been able to strengthen our B2B relationships with corporate and government clients, who now use our B2B payment platform to conduct more of their day-to-day banking work. In addition, our service offering of tailor-made financial solutions in project financing, investment advisory and digital payments have enabled us to attract new customers in the private and public sector, substantially increasing our transaction revenues in these areas.

## Power of personalization

The success of our digitalization strategy is enabled by our innovative approach to IT. Our IT team operates with a high degree of autonomy, within the parameters of NBO's defined vision, values and objectives. This autonomy, coupled with exceptional agility and committed management, enables the team to respond rapidly to customer needs and expectations. It enables us to not only create bespoke systems that precisely match our requirements, it allows us to continue to personalize and adapt our platforms as the needs of our customers change and evolve.

**Our values of customer first, one Bank, execution, quality and integrity were and continue to be our driving engine.**

Our three core retail banking propositions – Sadara, Mazaya and non-residents – are personalized to the very different needs of these customer groups. Our strong growth in the Youth banking market reflects the success of our personalized proposition in this segment, too, driven by factors such as the ongoing investment in our youth marketing team and the popularity of our revamped Nuqati rewards scheme, which now enjoys the highest net redemption ratio in the market, at 63 per cent.

Our revamped Al Kanz low cost savings account, which includes regular draws for savers to win big cash prizes, is also proving to be a powerful tool to motivate customers to build their wealth through savings, in line with Government efforts in this area.

## Careful cost management

Throughout our journey over the past 12 to 18 months, we have worked ceaselessly to keep our costs under control. We have reviewed our spending line by line and have identified efficiencies in many different places, keeping costs at a strategically acceptable level. Our Operations Group implemented a review of operational controls, identifying areas of automation and successfully increasing the efficiency of recovery teams to the extent that we significantly exceeded our target savings in this area.

**Highest**

**loyalty redemption net ratio at 63%**

At the same time, we have been very careful to ensure that our effective management of costs has not compromised our ability to generate revenues or implement our investment plans.

Part of this is about leveraging our strength as a national bank to make sure we are getting best value from our partners, such as landlords or suppliers. The other element is about investing in areas such as technology and innovation that enable us to create efficiencies elsewhere in our business.

Our continued investment in our mobile and online banking platforms, for example, to ensure they are as secure, reliable and user-friendly as possible, means





**To drive our future growth, we empowered our people to develop knowledge and skills.**

that more than 60 per cent of all our transactions are now conducted out of branch. This, in turn, frees up in-branch resources to focus on delivering more personalized, high quality services that exceed customer expectations.

## International stabilization

As well as being the first bank in Oman, we are also the only one with a banking license in the UAE, as well as a license in Egypt. However, in the past few years our UAE operations had, in common with other banks, suffered from the slow-down in the market, leading to some asset quality issues. Our relatively small size in the market meant that the impact in terms of our overall portfolio was higher, negatively affecting our profits in 2016 and 2017. So it is highly satisfying to report that this situation has been successfully addressed and our business in the UAE has been transformed.

By June 2018, after implementing a robust asset review and taking some tough decisions regarding our portfolio, we were fully-provided for all our bad assets in the UAE. We shrunk the portfolio to a level with which we are comfortable, while focusing on more stable asset classes.

This led to some short-term pain, but we now have a good basis to grow cautiously in the UAE and focus on implementing our new strategy. This centers on supporting the trade corridor between Oman and the UAE, leveraging our unique position as the only bank with the ability to offer seamless transactions between the two jurisdictions. It puts us in an ideal situation to capitalize on the considerable opportunities this presents in 2019 and beyond.

## Empowering our people

Of course, we recognize that none of these achievements would be possible without the hard work, commitment and dedication of our people, at all levels of our organization.

We understand that the strongest team usually wins the game. Our success depends on us having the best players, in being the employer of choice as well as the bank of choice. It is expensive to acquire good people from other banks, so our strategy is to recruit the best and then do all we can to retain them. By guiding and supporting our employees to reach their full potential with us, helping them to identify and secure new roles and opportunities, we are building a solid base of talent to drive our future growth.

One of the ways we have done this in 2018 is to empower our people to develop their knowledge and skills, to develop their careers at NBO, and to benefit from opportunities they wouldn't have elsewhere.

## We focus relentlessly on delivering a superior customer experience and prioritizing profit over growth.

Every individual has a clear sense of what is expected of them, what kind of opportunities are open to them, and what they need to do to prepare themselves to reach higher levels within the organization. Then we make sure they have all the resources and support to enable them to do that, and to contribute their ideas and creativity to the success of NBO.

## Investing in innovation

We believe innovation is central to the future development of Oman and we are committed to supporting entrepreneurial businesses and the people behind them.

In the five years that we have been running our Ibtikar innovation program, in which teams of employees compete to win development funding for their ideas and prototypes, 32 ideas have come to fruition. One of the latest is called 'Marketplace', which enables our merchant customers to target relevant offers and deals to retail customers using their NBO cards. It is adding value at both ends of the transaction and epitomizes the combination of digitalization, innovation and personalization that has driven our performance over the past 18 months. It also empowers our people to appreciate how their ideas and innovations can make a tangible contribution to our business.

Last year, our Academy of Excellence organized 439 training courses and delivered more than 10,000 training days in total, at an average of seven training days per employee. We also hired several new graduates, contributing to a 93% Omanization rate.

The new hires support the Government's pledge to create 25,000 jobs for Omani nationals that will further advance the economic and social development of Oman, in line with the Vision 2040 national development plan.

In a similar vein, our annual 24-hour 'hackathon' enjoyed a second successful year, with over 500 student developers, coders, programmers and designers challenged to find solutions that embrace the future of banking.

The hackathon is part of our commitment to encourage innovation and support Oman's young and talented minds. As is our 'Innovation in SME Award', which aims to engage with local entrepreneurs and SMEs, to help them turn their next great business idea into a commercial reality. We also introduced our 'Tijarati' SME speaker series, bringing together business influencers and thought-leaders to encourage debate, connections and knowledge-sharing among the country's small businesses and budding entrepreneurs.

## Strategy for sustainable success

We appreciate the support and guidance of our industry regulator, the Central Bank of Oman, which holds all banks in the Sultanate to the highest standards of governance, and we thank the Central bank of UAE for its continued support. We engage closely with our stakeholders on corporate governance issues and our annual audit ensures we adhere to regulations and comply with all changes introduced to support banks in this challenging environment, including our successful implementation of IFRS 9.

There is, of course, always more work to do to ensure long term success in a rapidly changing world. But our relentless focus on delivering a superior customer experience, and of prioritizing profit over growth, provides a solid, stable platform for sustainable success.

Combined with our team of empowered, committed people, our forward-looking strategy means we are strongly positioned to drive NBO forward through its next phase of growth, to support the development of Oman and its people, and to build a bank fit for the future.

**32**
**protoype ideas by employees come to fruition**

**430**
**training courses organized and completed**

**10,000**
**training days total throughout 2018**





**Combined with our team of empowered, committed people, our forward-looking strategy means we are strongly positioned to drive NBO forward through its next phase of growth, to support the development of Oman and its people, and to build a bank fit for the future.**

# Corporate Governance Report 2018

EY
Building a better working world

Ernst & Young LLC
P.O. Box 1750, Ruwi 112
5th Floor, Landmark Building
Opposite Al Ameen Mosque
Bowsher, Muscat
Sultanate of Oman

Tel: +968 22 504 559
Fax: +968 22 060 810
muscat@om.ey.com
ey.com/mena
C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

**REPORT OF FACTUAL FINDINGS**

**TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG**

We have performed the procedures agreed with you pursuant to the Capital Market Authority's (CMA) circular no. E/4/2015, dated 22 July 2015, with respect to the Board of Directors' corporate governance report of National Bank of Oman SAOG (the "Bank") as at and for the year ended 31 December 2018 and its application of the corporate governance practices in accordance with amendments to CMA Code of Corporate Governance issued under circular no. E/10/2016 dated 1 December 2016 (collectively the "Code"). Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures were performed solely to assist you in evaluating the extent of the Bank's compliance with the Code as issued by the CMA and are summarised as follows:

1) We obtained the corporate governance report (the "report") issued by the Board of Directors and checked that the report of the Bank includes as a minimum, all items suggested by the CMA to be covered by the report as detailed in the Annexure 3 of the Code by comparing the report with such suggested content in Annexure 3; and

2) We obtained the details regarding areas of non-compliance with the Code identified by the Bank's Board of Directors for the year ended 31 December 2018. The Bank's Board of Directors has not identified any areas of non-compliance with the Code.

We have no exceptions to report in respect of the procedures performed.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the corporate governance report.

Had we performed additional procedures or had we performed an audit or review of the corporate governance report in accordance with International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

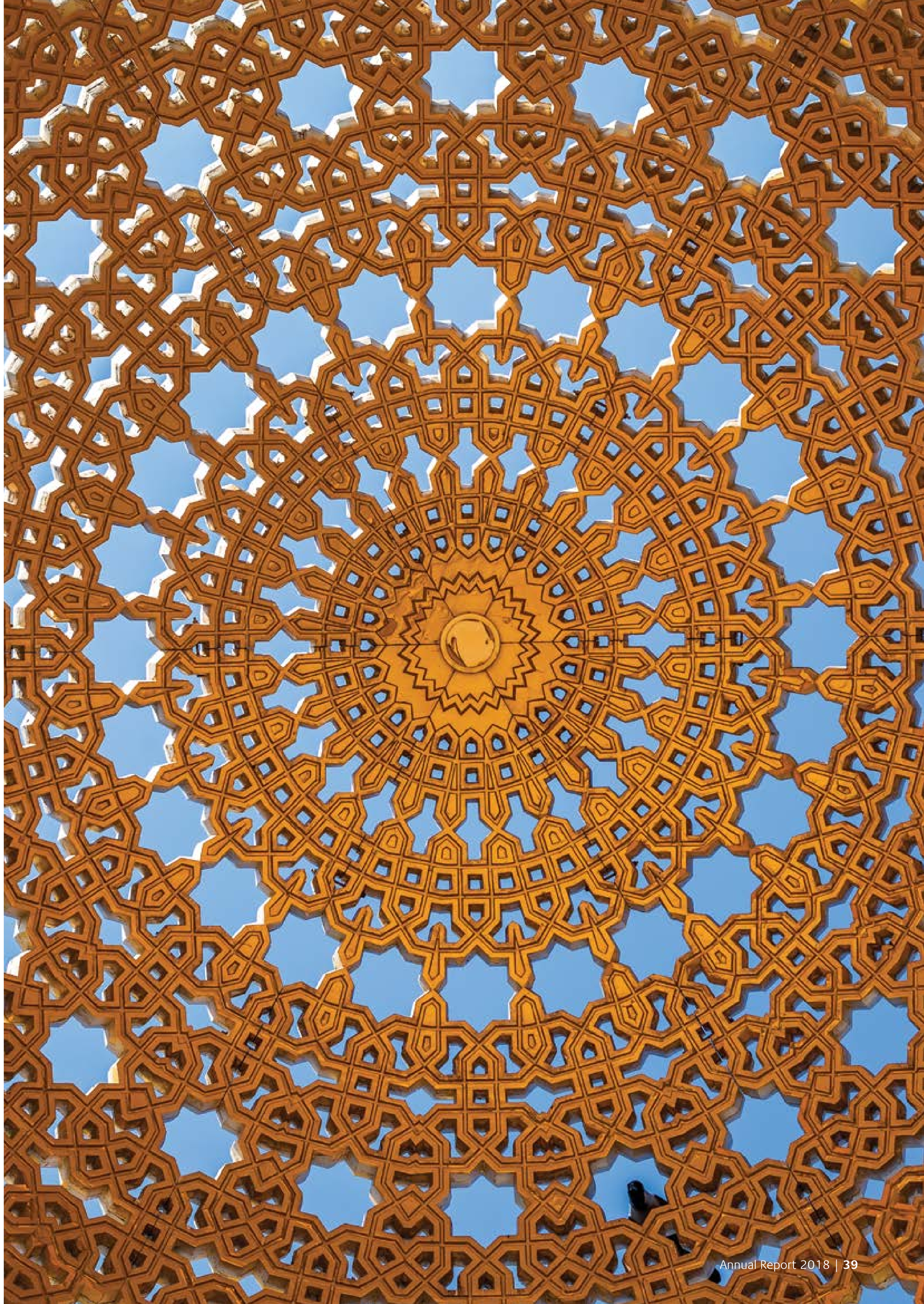
Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the accompanying corporate governance report of National Bank of Oman SAOG to be included in its annual report for the year ended 31 December 2018 and does not extend to any financial statements of National Bank of Oman SAOG, taken as a whole.

Ernst & Young LLC

ارنست ويونغ ش م م
س ت: ١٢٢٤٠١٣
ص ب: ١٧٥٠ روي - ١١٢ ، سلطنة عمان
EY ERNST & YOUNG LLC
C.R. No. 1224013
P.O. Box 1750 - P.C. 112, Sultanate of Oman

Muscat
10 March 2019





Corporate Governance Report – 2018

Corporate governance deals with the way companies are managed and led, defines the roles of the Directors and formalizes the internal control process within the institution.

The Board of Directors of National Bank of Oman (the Bank) supports the fostering of a healthy governance culture at the Bank. Accordingly, the Board and its Committees continuously evaluate and improve their governance practices, policies and procedures and confirm that the Bank applies the principles set out in the Capital Market Authority (the "CMA") Code of Corporate Governance (the "Code") as amended for Muscat Securities Market (the "MSM") Listed Companies and the regulations for Corporate Governance of Banking and Financial Institutions issued by the Central Bank of Oman (the "CBO").

The Bank received the following awards and accolades during 2018:

- Oman Entrepreneurship Award 2018, "Best Financial Support" at the third edition of the Oman Entrepreneurship Awards.
- "Excellence in Mobile Banking" by Oman Banking & Finance Awards, powered by Oman Economic Review.
- "Best Commercial Project" for the Head Office Building by the Dossier Construction Infrastructure Awards and Summit (DCIAS).
- "Luxury 100 Award" by Signature Magazine, for its Luxurious Banking Services 2018.
- The STP Excellence Award by Citibank, for its US dollar (USD) fund transfer service.

In accordance with the directives of the Code promulgated by the CMA, the Bank continues to include a separate report on the Bank's Corporate Governance which is duly certified by the statutory auditors within the Annual Report.

## Board of Directors

The Board of Directors is responsible for the overall direction, supervision and control of the Bank. Specific responsibilities of the Board include approving the business objectives of the Bank, approving strategies and policies which need to be pursued in order to achieve these objectives, and reviewing on an on-going basis the performance of the Bank in relation to its stated objectives as well as adherence to policies.

## Appointment of Directors

The Board is comprised of 11 members who were elected by the shareholders in March 2017 for a period of three years. The current term of all the Directors will expire at the end of March 2020.

## Process of nomination of the Directors

The nomination of the Directors is as per Articles 29 to 34 of the Bank's Articles of Association and also in accordance with CBO, CMA, Ministry of Commerce and Industry ("MOCI") and MSM regulations. The ENRC reviews the appropriate skills and characters required of the Board Members and recommends suitable names to the shareholders for election. Shareholders retain the power to elect any candidate to the Board irrespective of whether the candidate is recommended by the Board or otherwise.

## Characteristics and core competency of the Board

Members of the Board and its committees bring appropriate knowledge and experience as well as independent judgment to Board meetings and in passing resolutions. The Board collectively possesses professional knowledge, business expertise, industry knowledge and financial awareness to carry out its oversight responsibilities over the Executive and Senior Management of the Bank.

## Information given to the Board

The Directors are given appropriate and timely information so that they can maintain full and effective control over strategic, financial, operational, risk, compliance and governance issues. The information provided to the Board is as per the guidelines provided in the Code.

On appointment, each Director receives information about the Bank through an induction pack and is advised of the legal, regulatory and other obligations devolving upon a Director of listed companies.

## Composition of the Board

No Director is a member of the Board of more than four public joint stock companies or banks whose principal place of business is in the Sultanate of Oman, or is a Chairman of more than two such companies.

The following tables show the position of each of the current Board members in line with the Code's requirements:

### Table (1)

| Name of Director | Representing | Category of the Director* |
|---|---|---|
| Sayyida Rawan Ahmed Al Said – Chairperson | Herself | NEX-IND |
| Sheikh Abdulla Bin Ali Bin Jabor Al Thani Deputy Chairman | The Commercial Bank–Equity Investor | NEX-NIND |
| Ms. Amal Suhail Bahwan – Director | Suhail Bahwan Group Holding–Equity Investor | NEX-NIND |
| Mr. Hamad Mohammed Al Wahaibi – Director | Himself | NEX-IND |
| Mr. Mohd Ismail Mandani Al Emadi – Director | Himself | NEX-NIND |
| Mr. Rahul Kar – Director | Himself | NEX-IND |
| Mr. Fahad Abdul Rahman Badar – Director | Himself | NEX-NIND |
| Mr. Ghassan Khamis Ali Al-Hashar – Director | Public Authority for Social Insurance–Equity Investor | NEX-IND |
| Mrs. Najat Ali Al Lawatia – Director | Civil Service Pension Fund–Equity Investor | NEX-NIND |
| Mr. Rashid A Saadi | Himself | NEX-IND |
| Mr. Joseph Abraham | Himself | NEX-NIND |

*NEX: Non-Executive Director, IND: Independent, NIND: Non Independent*

As per the CMA guidelines, five Board members are currently considered as independent (which is more than one third of the Board) as per the required minimum number of Independent Directors as stated in the Bank's Articles of Association and the Commercial Companies Law.

### Table (2)

| Name of the Director | Other Board Committees Membership* | No. of other S.A.O.G Boards Membership | No. of Board meetings attended | Attended last AGM on 25th March 2018 |
|---|---|---|---|---|
| Sayyida Rawan Ahmed Al Said – Chairperson | ENRC | 1 | 8 | Yes |
| Sheikh Abdulla Bin Ali Bin Jabor Al Thani – Deputy Chairman | ENRC | NIL | 10 (1 by proxy) | Yes |
| Ms. Amal Suhail Bahwan | ENRC / BRC | 2 | 9 (1 by proxy) | Yes |
| Mr. Mohd Ismail Mandani Al Emadi | BRC / BAC | NIL | 10 (2 by proxy) | Yes |
| Mr. Hamad Mohammed Al Wahaibi | CCB / ENRC | 2 | 8 | Yes |
| Mr. Rahul Kar | BAC | 2 | 10 | Yes |
| Mr. Fahad Badar | CCB | NIL | 10 (2 by proxy) | Yes |
| Mr. Ghassan Al-Hashar | BAC / BRC | 1 | 10 | Yes |
| Mrs. Najat Al Lawatia | CCB | 1 | 9 | Yes |
| Mr. Rashid Al Saadi | BAC / CCB | 2 | 10 (1 by proxy) | Yes |
| Mr. Joseph Abraham (Appointed on May 7th 2018) | ENRC | NIL | 5 | No |
| H.E Abdul Rahman Hamad Al Attiyah (Resigned on 18 April 2018) | BRC | NIL | 3 | Yes |

**BAC: Board Audit Committee, CCB: Credit Committee of the Board, BRC: Board Risk Committee, ENRC: Executive, Nomination and Remuneration Committee.*

Corporate Governance Report – 2018

## Number and dates of Board meetings

National Bank of Oman held ten Board meetings during 2018. They were on January 28th, February 21st, March 25th, April 29th, May 14th, July 29th, September 12th, October 29th, December 16th and December 20th 2018. The maximum interval between two meetings was 76 days. This is in compliance with the current regulations, which require meetings to be held within a maximum time gap of four months.

## Remuneration to Board and Top Management

The sum of the benefits (e.g. salaries, perquisites, bonuses, gratuity, pension, etc.) paid to currently active top 5 senior managers of the Bank in 2018 is RO 1,698,439/-.

Staff service contracts are two years for expatriate officers and determined by the prevailing labor laws for Omanis. The notice period is between one to three months for the existing contracts.

As all members of the Board are Non-Executive Directors, accordingly no fixed remuneration or performance linked incentives are applicable. The Non-Executive Directors are paid sitting fees and reimbursement of expenses for attending the Board and Committee meetings. In addition to the sitting fees paid, the total remuneration for the Directors, in 2018, is RO 91,150.000 subject to the Annual General Meeting approval proposed to be held on 25th March 2019.

The details of the sitting fees paid or accrued for payment during 2018 are as follows:

### Table (3)

| Name of the Directors | Total fees RO | Remarks |
|---|---|---|
| Sayyida Rawan Ahmed Al Said – Chairperson | 10,000* | |
| Sheikh Abdulla Bin Ali Bin Jabor Al Thani – Deputy Chairman | 10,000* | |
| Ms. Amal Suhail Bahwan | 10,000* | |
| Mr. Mohammed Ismail Mandani Al Emadi | 10,000* | |
| Mr. Hamad Mohammed Al Wahaibi | 10,000* | |
| Mr. Rahul Kar | 10,000* | |
| Mr. Fahad Badar | 10,000* | |
| Mr. Ghassan Al-Hashar | 10,000* | |
| Mrs. Najat Al Lawatia | 10,000* | |
| Mr. Rashid Al Saadi | 10,000* | |
| Mr. Joseph Abraham | 6,000 | Appointed on 7 May 2018 |
| H.E. Abdul Rahman Hamad Al Attiyah | 2,850 | Resigned from the Board on 18 April 2018 |
| **Total** | **108,850** | |

**The total amount of sitting fees that can be paid to a Director during a financial year is RO 10,000 according to the current regulations.*

The total training, hotel and travel expenses related to the Board Members during 2018 is RO 57,010.

## Board Committees

As at the end of December 2018, The Board of Directors has four standing committees: Executive, Nomination and Remuneration Committee (ENRC), the Board Audit Committee (BAC), the Board Risk Committee (BRC) and the Credit Committee of the Board (CCB).

## Board Audit Committee (BAC):

The BAC comprises of four members, three of which are independent and one is non-independent. The committee met eight times in 2018.

The composition of the BAC and particulars of meetings attended by the members of the BAC are given in table 4.



### Table (4)

| Name | Position | Meetings attended | Remarks |
|---|---|---|---|
| Mr. Rahul Kar | Chairperson | 8 | |
| Mr. Mohd Ismail Mandani Al-Emadi | Member | 7 | |
| Mr. Ghassan Khamis Al Hashar | Member | 8 | |
| Mr. Rashid Al-Saadi | Member | 7 | |

The Audit Committee Charter which specifies the responsibility and authority of the Board Audit Committee is approved annually by the Board.

The responsibilities of the Committee as specified in the Audit Committee Charter include but are not limited to:

- Provide recommendation to the Board of Directors for putting before the Annual General Meeting for the appointment and removal of external auditors as well as specifying the fees considering the independence of such auditors.
- Discuss with the external auditors their audit plan and the results of their audit including whether they have had full access to all relevant documents.
- Approve non-audit services awarded to the external auditors (statutory) prior to commencing engagements and ensure that their independence is not compromised in any manner, further such engagements comply with Capital Market Authority Oman (CMA) regulations.
- Review and approve the Audit Division's Charter, annual budget, staffing and their compensation (including bonus) and organization structure of audit division.
- Review and approve the appointment, promotion, replacement, reassignment or dismissal of the Chief Internal Auditor of the bank.
- Review and discuss and approve the overall scope of the annual internal audit plan with the Chief Internal Auditor including the adequacy of the individual audits, staffing and their full access to all relevant documents.
- Review the effectiveness of the internal audit function, including conformance with the Institute of Internal Auditors' the Definition of Internal Auditing, Code of Ethics and the International Standards for Professional Practice of Internal Auditing.
- Review and discuss with the Chief Internal Auditor, the findings of critical importance arising from the internal audits carried out in the period between meetings.
- Review management's responsiveness to internal audit findings and recommendations and assess internal audit effectiveness.
- Review and discuss with the management, internal auditors and external auditors the adequacy and effectiveness of the internal control system, including information technology security, accounting and financial controls and the bank's system to monitor and manage business risk, and its legal and ethical compliance programs. They may appoint external consultants if deemed necessary.
- Submit the minutes of all meetings of the Audit Committee to or discuss the matters discussed at each committee meeting with the Board of Directors of the Bank.
- Periodically assess and report to the Board of Directors, its own performance against its annual work plan, considering the effective use of committee time, responsiveness to the Board-approved charter, and the effectiveness of relationships and communications with management, auditors and the full Board.
- Review and reassess the charter at least annually and obtain the approval of the Board of Directors.
- Meet with external and internal auditors separately, at least once per annum without the management, to hear their views and to consult them vis-à-vis enhancing the level of corporate governance and compliance.
- Serve as a channel of communication between external auditors and the Board and also internal auditors and the Board.
- Oversee the financial reporting process on behalf of the Board including review of the annual and quarterly financial statements before publication, review of qualifications/ reservations in the draft financial statements and discussion of the accounting principles. In particular, any changes in the accounting policies, principles and accounting estimates in comparison to the previous year any adoption of new accounting policy, any departure from International Financial Reporting Standards (IFRS) and non-compliance with the disclosure requirements prescribed by regulatory authorities such as CBO, CMA etc., should be critically reviewed and discussed with the management and auditors.
- Ensure that management of the Bank has put in

Corporate Governance Report – 2018

place an appropriate system for the adoption of relevant accounting policies and principles leading to the true and fairness of the financial statements. Against this system, the committee should review the financial statements for any content of fictitious or fraudulent nature.

- Review the details of all proposed related party transactions in line with the Bank's policy (complies with the CMA code of Corporate Governance) and provide appropriate recommendation to the Board.
- Periodically review internal audit findings on the 'restructured' loans upgraded to 'regular' category for information and provide appropriate directions thereon to the management.
- Review of details of fraud reports presented in line with CBO regulations.

## Credit Committee of the Board (CCB):

The CCB comprises of four members. The committee has met eleven times during 2018. The names of the members, their positions and their meeting attendance appear in the table below:

### Table (5)

| Name | Position | Meetings attended | Remarks |
|---|---|---|---|
| Mr. Hamad Al Wahaibi | Chairperson | 8 | |
| Mr. Fahad Badar | Member | 7 | |
| Mrs. Najat Ali Al Lawatia | Member | 6 | |
| Mr. Rashid Al-Saadi | Member | 7 | |

The CCB's main responsibilities include but are not limited to:

- Approve and renew credit transactions up to the maximum legal limits of the Bank including underwriting exposures and sell down targets.
- Review reports of risk assets covering bank wide portfolio trends including higher risk assets, exposures as well as the other reports at least every quarter.

## Board Risk Committee (BRC):

The Board Risk Committee comprises of four members. The committee has met seven times during the year 2018. The major responsibilities of the committee include risk identification and review, risk policy, risk limits and risk management and monitoring, review management of recovery strategies of problem loans and adequacy of provisioning.

The names of the members of the BRC, their positions and their meeting attendance appear in the table below:

### Table (6)

| Name | Position | Meetings attended | Remarks |
|---|---|---|---|
| Mr. Mohd Ismail Mandani Al-Emadi | Chairperson | 6 | |
| Ms. Amal Suhail Bahwan | Member | 4 | |
| Mr. Ghassan Khamis Al Hashar | Member | 6 | |
| Mr. Fahad Badar | Member | 5 | Joined the committee on 29 April 2018 |
| H.E. Abdul Rahman Hamad Al-Attiyah | Member | 1 | Resigned from the Board on 18 April 2018 |

The responsibilities of the Committee as specified in the Terms of Reference which includes but is not limited to:

1. The Committee sets the policy on all risk issues and maintains oversight of all Bank risks through the Management Risk Committee (MRC). More specifically the key responsibilities of the Committee are:

a) Approval of new policies of the Bank and periodic review of existing policies.

b) To establish an appropriate Credit Risk Environment.

c) To develop appropriate Operational Risk Management.

d) To consider the strategic Risks facing the Bank and refer suggestions for mitigating such risks to the full Board.

e) To maintain an oversight on Interest Rate Risk, the bank's balance-sheet and income risks.

f) Management of Liquidity Risk.

g) Management of all other Market Risks including Foreign Exchange.

h) Approval of credit loss write-offs which are over the limits prescribed for the Management.

i) Management of People Risk.

j) Overseeing information security risk and business continuity risk.

k) Review management of recovery strategies of problem loans and adequacy of provisioning.

l) Formulation and review of the Key Risk Appetites of the Bank.

2. Specific Responsibilities of the Committee include the following:

a) Recommend the Risk Strategy of the Bank, including but not limited to credit strategy, for Board approval.

b) Recommend the Risk Charter of the Bank for Board approval, review the Charter annually.

c) Set a high-level bank-wide risk policy framework within the segments of credit, market, operational, reputational, legal, strategic and accounting risks.

d) Establish risk tolerance levels and portfolio limits, including limits associated with industry sector, geography, asset quality and others, as appropriate.

e) Monitor the enterprise-wide dashboard of risk through the MRC.

f) Review and assess the performance of MRC and the Risk Group in monitoring and controlling all risk to ensure that risk strategies and policies approved by the Board are adhered to and implemented.

g) Direct oversight over Regulatory and Legal Compliance through the MRC.

h) Regularly review stress scenarios to measure the impact of unusual market conditions and monitor variance between the actual volatility in portfolio values and that predicted by the risk measures.

i) Monitor compliance of various risk parameters by business lines.

j) Approval and annual review of all asset and liability product strategies to include but not be restricted to, all retail lending products and deposit products, treasury and investment products and any other non-standard products relating to corporate banking.

k) Direct oversight over specific credit policy issues including but not limited to:

- Credit rating models, country limits, concentration issues, loan review mechanism and findings classification policy for loans and provisioning policy.
- Approval of new product strategies/ initiatives having credit implications for the Bank.
- Review of appropriateness of credit authorities and delegations to management.
- Periodic review of the Bank's Credit Risk Rating methodology and appropriateness of risk ratings.

l) Endorse the ICAAP document for the approval of the Board.

m) Review the Corporate Governance Report.

Corporate Governance Report – 2018

## Executive, Nomination & Remuneration Committee of the Board (ENRC)

The ENRC comprises of five members and met nine times during the year 2018.

The names of the ENRC members, their positions and their meeting attendance appear in the table below:

### Table (7)

| Name | Position | Meetings attended | Remarks |
|---|---|---|---|
| Sayyida Rawan Ahmed Al Said | Chairperson | 8 | |
| Sheikh Abdulla Bin Ali Bin Jabor Al Thani – Deputy Chairman | Member | 8 | |
| Ms. Amal Suhail Bahwan | Member | 9 | |
| Mr. Hamad Mohammed Al Wahaibi | Member | 7 | |
| Mr. Joseph Abraham | Member | 5 | Joined the committee on 7 May 2018 |

The main responsibilities of the ENRC as specified in the Terms of Reference include but are not limited to:

- Develop the long term strategy of the Bank based on economic and market conditions and the Board's vision and recommend it for Board approval.
- Review the Bank's overall strategy and monitor implementation and execution.
- Review the performance of the Bank against approved strategy and budgets.
- Review and recommend for Board approval the Bank's annual Budgets and Business Plans including all Operating and Capital Expenditure budgets of the Bank in line with the long term strategy and changes in economical, market and regulatory environments.
- Review reports and analysis of the Bank's financial and operating performance, and evaluate key performance indicators against their accompanying strategies.
- Review the performance of the Investment Banking function including all investments reports.
- Review and recommend to the Board the Bank's proposals for Capital Raising Plan.
- Review and approve the Banks Dividend Policy and recommend to the Board the proposed dividend payout.
- Review and approve NBO's brand vision.
- Review and approve the Bank's Human Resources Manual and Policy and the Bank's Compensation Policy and Bonus Plan.
- Be responsible for setting the Bank's remuneration framework for management and staff as per the Bank's Compensation Policy and Bonus Plan and ensure its proper implementation.
- Review prevailing compensation and benefits and ensure consistency with market trends as per the Bank's Compensation Policy and Bonus Plan in accordance with regulatory guidelines.
- Review, approve and amend policies related to employee reward and performance related incentive plans and assume the function and responsibilities of the Remuneration Committee as specified in the Bank's Compensation Policy as approved by the Board.
- Handle appointment and movement of key executives in the Bank from the reward level Assistant General Manager (AGM) and above.
- Review and approve major changes in the Bank's organizational structure at the level of Divisional Heads and above.
- Have specific responsibility to recommend for Board approval, and to review and update as necessary, a general strategy and policies for the acquisition, ownership and development of the Bank's properties.
- Approve the acquisition and sale of any property required for the business of the Bank.
- Approve the appointment of construction companies and consultants for the Bank's Head Office, and agree the terms of any construction contract (including any variation order), consultancy or property or facilities management contract relating to any property owned by the Bank.
- Shall oversee the performance and implementation of any property-related projects.
- Propose the annual CSR and Sustainability budget to the Board, which shall submit the same to the shareholders in their Annual General Meeting for approval.
- Identify methods of payment for CSR and Sustainability initiatives.
- Submit a report at the end of the year to the AGM for ratification of amounts paid to CSR and Sustainability initiatives.
- Adopt a transparent method in preparing the Nomination Policy targeting directors of high competence and caliber, without prejudice to the right of any of the shareholders to stand for election or to nominate whoever they see fit.
- Exert the best efforts to the assist the Bank in formulating clear, credible and accessible policies to inform the shareholders about Director's and executives' remuneration.
- Prepare detailed job descriptions of the role and responsibilities for Directors including the Chairperson. This will facilitate the orientation of the Directors towards their tasks and roles and appraise their performance.
- Look for and nominate qualified persons to act as interim directors on the Board in the event a seat becomes vacant.

**Corporate Governance Report – 2018**
Board Members Profiles

Corporate Governance Report – 2018
Board Members' Profiles

## Sayyida Rawan Ahmed Al Said, Chairperson

Chairperson of the Executive, Nomination and Remuneration Committee (ENRC)

Sayyida Dr. Rawan Ahmed Al Said is the CEO of Takaful Oman SAOG, prior to joining Takaful Oman, she was the Managing Director and CEO of ONIC Holding Corporation. Before moving to the Private Sector, Rawan was the Deputy CEO-Investment for the State General Reserve Fund of Oman, leading the execution of many mega investments internationally. She has almost 30 years of experience in the financial industry, 20 of which are in the Public sector. Sayyida Rawan remains to be the First and the only Female who holds a CEO position in a public listed company in Oman.

She has been a member on the Board of a number of reputed Companies and Financial Institutions in Public and private sector in Oman and the GCC region. Chairperson in National Bank of Oman, Deputy Chairperson in Oman Oil Marketing Company, Board Member of Oman National Investments Development Company ONIDCO (Tanmia) and Chairperson of its equity and GCC funds committee. In the public sector, she was on the board of Oman Oil Company SOAC and its audit committee. She was on the Board Member of International General Insurance (IGI) Jordan, and National Finance House (NFH), Bahrain. Deputy Chairperson of Orix Finance, National Life & General Insurance Company SAOC (NLIG) and Al Ahlia Insurance.

She is also a Member on the Investment Committee of the Public Authority for Social Insurance, Board Member in Public Authority for the SME Development (Riyada). Chairperson of Al Kawther Fund (Islamic Compliant Fund) and a Member of the Investment Committee of Orphans & Incapacitated Funds in the Ministry of Justice. She has been recently appointed as a Board member of the Sultan Qaboos University Council.

**Awards and Recognition:**

In 2011, she was bestowed the Business Professional (BizPro) Leader Award. In 2012, was ranked 14th in Forbes Middle East for the 'Most Powerful Arab Business Women in Listed Companies'. In 2014, Rawan was named among the Best Chief Executives in the region by Trend in collaboration with INSEAD (The Business School for the World). Also she was Awarded Hall of Fame by MARA Excellence Awards. In 2015, she was honored with two prestigious Awards; Asian Women Leadership of the Year from World Leadership Congress and in MENA and Business Leader of the year from the Middle East Accountancy and Finance Excellency Awards 2015. In 2016 she was honored with Honorary Doctorate Degree from Commonwealth University in UK and she was awarded as the Best Takaful CEO from Global Business Outlook, UK. Dr. Rawan ranked 3rd in Oman for Forbes the Top 100 most powerful Arab Businesswomen 2017. In 2017 and 2018 she won the best CEO-Oman award from International Finance UK and she won Oman Women of the year awards 2018 for the inspirational woman category.

Sayyida Dr. Rawan, has an MSc in Economics & Finance from Loughborough University UK. She also holds a Post Graduate Diploma in Investment Analysis from Stirling University UK, and BA in Economics & Political Science from the American University in Cairo (AUC).

## H.E. Sheikh Abdulla Bin Ali Bin Jabor Al Thani, Deputy Chairman

Member of the Executive, Nomination and Remuneration Committee (ENRC)

H.E. Sheikh Abdulla bin Ali bin Jabor Al Thani has been a Director of the Bank since July 2005 and serves as a member of the Board Executive, Nomination and Remuneration Committee (ENRC). His Excellency is the Chairman of The Commercial Bank (P.S.Q.C.) in Qatar, a member of the Board of Directors for United Arab Bank, P.J.S.C. in UAE and is the Owner of Vista Trading Company (Qatar), and a Partner in Integrated Intelligence Services Company (Qatar).

H.E. Sheikh Abdulla bin Ali bin Jabor Al Thani holds a Bachelor of Arts Degree in Social Science from Qatar University.

## Ms. Amal Suhail Bahwan, Director

Member of the Executive, Nomination and Remuneration Committee (ENRC) and the Board Risk Committee (BRC)

Ms. Amal Suhail Bahwan is the Vice Chairperson of Suhail Bahwan Group Holding LLC. She has extensive experience in managing companies across the Bahwan Group.

She is also the Chairperson and Executive Committee member of Al Jazeera Steel Products Co. SAOG. and Director and Board Remuneration Committee member of Oman Oil Marketing Co. SAOG.

Ms. Amal has a Bachelor's degree in Education and a Master's degree in Administration from the Sultan Qaboos University.

## Mr. Hamad Mohammad Hamood Al Wahaibi, Director

Chairperson of the Credit Committee of the Board (CCB) and Member of the Board Executive, Nomination and Remuneration Committee (ENRC)

Mr. Hamad Mohammad Al Wahaibi has been a Director of the Bank since March 2014. He has 20 years of experience in the GCC. He has been a director of investment with the Ministry of Defense Pension Fund for the past six years. Mr. Al Wahaibi is also a member of the boards of Voltamp Energy Company and ACWA Power Company.

Mr. Al Wahaibi holds a Masters of Business Administration (MBA) degree, specializing in Finance, and he is a Chartered Financial Analyst (CFA) charter holder, Chartered Alternative Investment Analyst (CAIA) charter holder, as well as a Certificate in Investment Performance Measurement (CIPM) Certificant.

## Mr. Mohammed Ismail Mandani Al Emadi, Director

Chairperson of the Board Risk Committee (BRC) and Member of the Board Audit Committee (BAC)

Mr. Mohammed Ismail Mandani Al Emadi has been a Director of the Bank since November 2014. He is also a member of the Board for The Commercial Bank (P.S.Q.C.) and a member of the Board of Alternatifbank A.S. (ABank), Turkey and has over 30 years of banking experience. Mr. Al Emadi has held a number of key roles at Commercial Bank until 2006, after which he served as Chief Executive Officer of Qatar Real Estate Investment Company Q.S.C. up to 2011, and also served as its Director from 2003 until 2005.

Mr. Al Emadi holds a Bachelor of Arts Degree in Business Administration and Economics from Holy Names University, California.

## Mr. Rahul Kar, Director

Chairperson of the Board Audit Committee (BAC)

Mr. Rahul Kar has been a Director of the Bank since April 2016. Mr. Kar is a Chartered Accountant and is currently working as the Financial Advisor to the Chairman of Suhail Bahwan Group Holding LLC.

Mr. Kar is also a Director and an Audit committee member of Al Jazeera Steel Products Co. SAOG. He is also a Director and Nomination & Remuneration committee member of Oman United Insurance Company SAOG.

## Mr. Fahad Badar, Director

Member of the Credit Committee of the Board (CCB) and the Board Risk Committee of the Board (BRC)

Mr. Fahad Badar has been a Director of the Bank since May 2016. He is also a member of the Board for United Arab Bank, P.J.S.C. in UAE since July 2016.

Mr. Badar's career at The Commercial Bank (P.S.Q.C.) in Qatar spans over 19 years. Prior to his current role as Executive General Manager, International Banking, he held a number of key roles in International Banking, the Government and Public Sector Relations and the Wholesale Banking Divisions.

Mr. Badar holds an MBA from Durham University, UK and a Bachelor of Arts Degree in Banking & Finance from the University of Wales.

## Mr. Ghassan Khamis Al Hashar, Director

Member of the Board Audit Committee (BAC) and the Board Risk Committee (BRC)

Mr. Al Hashar joined NBO Board as a representative of the Public Authority for Social Insurance (PASI) in March 2017. He is currently the Authority's Director of Investments. He has over 20 years of experience in finance and investment management, and represents PASI on the boards of numerous public and private companies. He is also a Board Director at National Life & General Insurance Company SAOG and Oman National Investments Development Company SAOC (TANMIA).

Mr. Al Hashar holds a Master's Degree in Finance and Investment Management.

## Mrs. Najat Ali Al Lawatia, Director

Member of Credit Committee of the Board (CCB)

Ms. Najat Ali Al Lawatia was elected as a Director of the Bank at the AGM in March 2017. She holds a Commerce Bachelor Degree in accounting and has attended various courses in diverse fields of financial management, audit, investments etc. She is working as the Deputy Director General for Support Services with Civil Service Employees Pension Fund and has more than 20 years of relevant experience.

Ms. Najat is also a Director and Chairperson of Audit Committee of Oman Cement Company SAOG.

## Mr. Rashid Bin Saif Al-Saadi, Director

Member of the Board Audit Committee (BAC) and a Member of the Credit Committee of the Board (CCB)

Sheikh Rashid has been a member of the Board of Directors since August 2017, and is a renowned financial and investment banker, business executive, entrepreneur and philanthropist. Sheikh Rashid is also the CEO of TANMIA, a company that actively contributes to the Sultanate's economic development.

Sheikh Rashid holds a B.Sc. in Business Administration from Rollins College, USA. His career is marked by many significant achievements and milestones; including a twelve year stint with the Diwan of Royal Court.

In 2000, Sheikh Rashid was appointed CEO of TANMIA, which was setting up its Investment Fund with the Muscat Securities Market at the time. Following his appointment, the Board of Directors decided to transfer the responsibilities of managing the fund to the company directly, and two new Funds were set up subsequently; a Private Equity Fund, the GCC Investment Fund, and the Shari'a Fund in 2013. In addition, Sheikh Rashid also drove direct investments into various industries, including and not limited to Real Estate Development; the company played an active role in the development of the Al Mouj Muscat Project, and in the Tourism sector, the company played a key role in setting up the Kempinski Hotel, Muscat. In the Industrial Sector the company contributed to the establishment of Octal Petrochemicals, also extending into the retail sector by partnering with Al Meera Group to set up its business in the Sultanate.

In addition to his executive responsibilities, Sheikh Rashid is the Chairman of Board of Directors of Takaful Oman SAOG and A'saffa Foods SAOG. He is also a Director on the Boards of Oman National Finance Co. SAOG, Minerals Development Company SAOC, Muscat National Development and Investment SAOC, Almouj Muscat & Oman Hospitality Company.

## Mr. Joseph Abraham, Director

Member of the Executive, Nomination and Remuneration Committee (ENRC)

Mr. Abraham was appointed as a Board Member of NBO in May 2018.

Mr. Abraham is the Group Chief Executive Officer of The Commercial Bank as well as Vice-Chairman of the Board of Directors of Alternatif Bank and a Board Director of the United Arab Bank, UAE. He has extensive banking experience across both developed and emerging markets. Before joining The Commercial Bank in June 2016, he was CEO of ANZ Indonesia (Australia and New Zealand Banking Group) based in Jakarta, a position he served in from 2008 to 2016. Mr. Abraham has an MBA from the Graduate School of Business, Stanford University, California and has worked in Indonesia, Singapore, Hong Kong, Ghana, UK and India in various country and regional banking roles with a successful track record covering general management, corporate banking, strategy, product management as well as acquisitions and integrations. Mr. Abraham was appointed as a Board Member of Alternatif Bank in December 2016.



Corporate Governance Report – 2018
Board Members' Profiles

## Composition of the Management

The organization chart of the Bank's management includes an Acting Chief Executive Officer (ACEO) as the leader of the organization whose appointment, functions and package are determined by the Board.

The General Managers are appointed to assist the ACEO and to lead functional groups in the Bank. The organization chart also includes Divisional Heads of all the direct subordinates of the ACEO. The following table gives details of the top eight management officers along with their positions:

### Table (8)

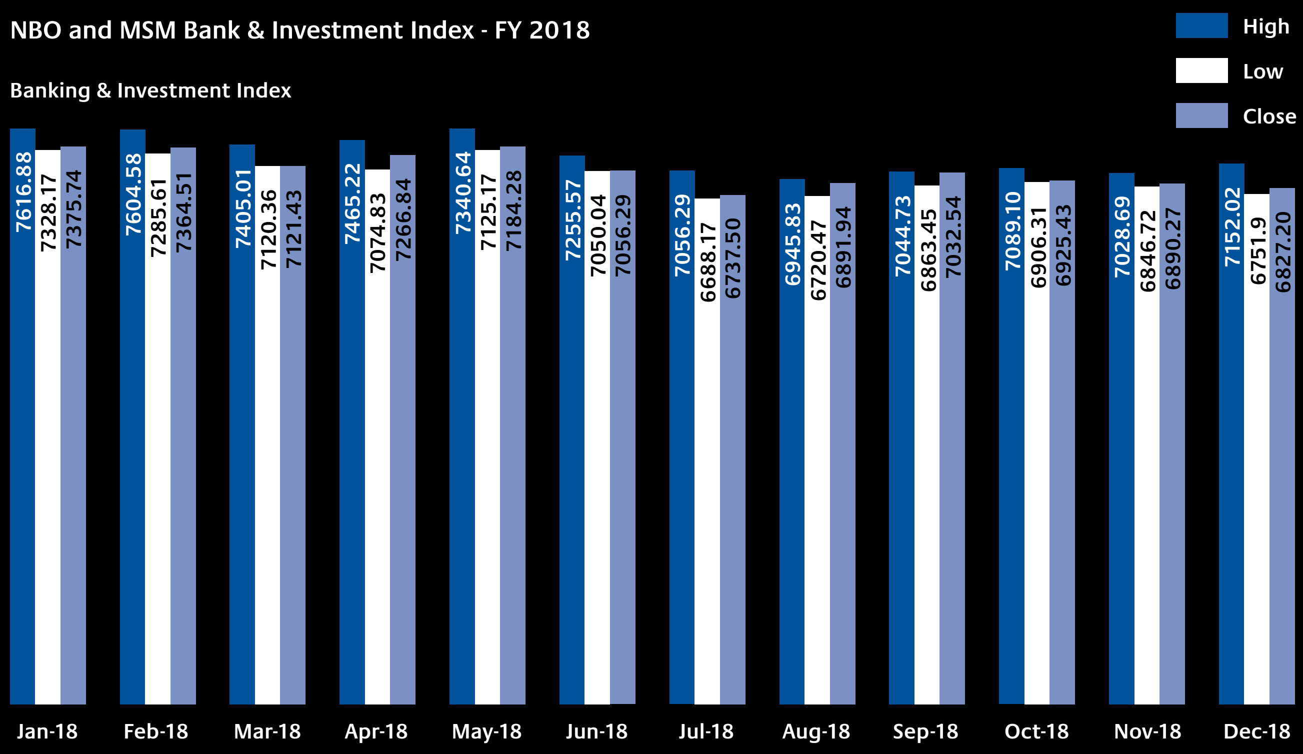
| Name of the Directors | Position |
|---|---|
| Al Sayyid Wasfi Jamshid Al Said | Acting CEO |
| Nasser Mohammed Al Hajri | GM–Chief Operating Officer (COO) |
| Ananthraman Venkat | GM–Chief Financial Officer (CFO) |
| Hassan Abdul Amir Shaban | GM–Chief Government Banking Officer |
| Nasser Salim Al Rashdi | GM – Chief Commercial Banking Officer |
| Salma Salim Said Al Jaaidi | GM–Chief Risk Officer |
| John Chang | GM – Chief Retail Banking Officer |
| Faizal Mohamed Eledath | GM–Chief Transformation Officer |

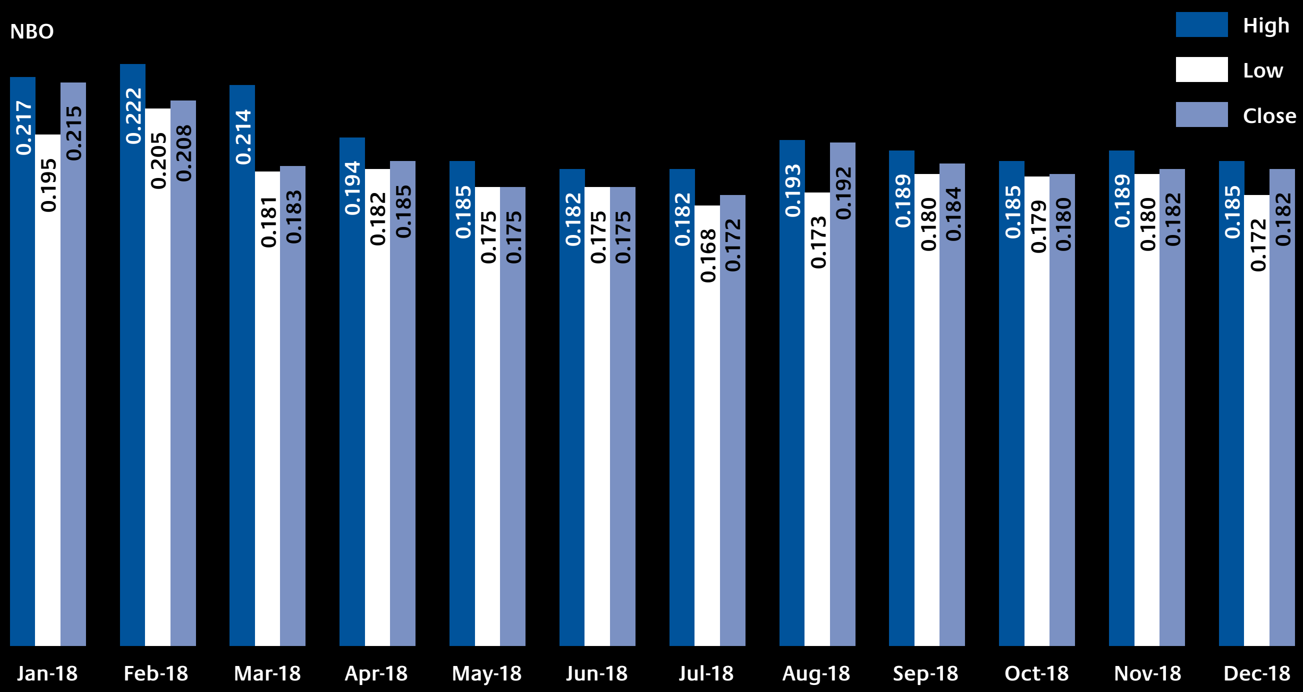
## Market Price Data:

The following table shows the high, low, and average prices of the Bank's shares and compares the Bank's performance against the broad index of banks and investment companies during 2018.

### Table (9)

NBO and MSM Bank & Investment Index - FY 2018








## Related Party Transactions

Details of all transactions where a Director and/or other related parties might have a potential interest are provided to the Board for their review and approval, and the interested Director neither participates in the discussions, nor do they vote on such matters.

On a half yearly basis, as of June 30th and December 31st of each financial year, the details of the Bank's related parties are produced and submitted to the Central Bank and other regulatory bodies for information and proper disclosure.

Details of all the related party transactions are provided to the shareholders as part of the financial statements submitted for approval at the Annual General Meeting along with the statement that transactions are on an arm's length and independent basis and are reasonable.

## Internal Control Review

The Board attaches great importance to maintaining a strong control environment and their review has covered all controls, including financial, operational, compliance and risk management.

The Board has a collective responsibility for the establishment, maintenance and review of a system of internal controls that provides reasonable assurance of effective and efficient operations, internal financial control, and compliance with the relevant laws and regulations.

The Board has established a management structure that clearly defines roles and responsibility and reporting lines and has approved the updated policies including credit, expenditure, disclosure, corporate governance etc.

The Bank's financial position, operational and business performance is regularly reported to the Board. The actual performance achieved against budgets and prior period is reported and closely monitored.

Financial information is prepared using appropriate accounting policies that are consistently applied.

Operational procedures and controls have been established to facilitate complete, accurate and timely processing of transactions and the safeguarding of assets. They are monitored through compliance with policies and procedures manuals, desk performance instructions and other circulars.

## Shareholders

### Communication with shareholders and investors

The Board is committed to ensure that all material information relating to the Bank's business operations is regularly communicated to its stakeholders and members of the investment community.

The Bank has its own web site, where relevant information relating to the Bank, its products, its operations and annual and quarterly financial statements are posted. The Bank's web-site address is www.nbo.om.

- Quarterly results are published and made public. Investor Relations page / Results & Reports page

The quarterly, half-yearly, and annual results of operations of the Bank are published in leading Arabic and English newspapers in the Sultanate of Oman. After completion of the statutory audit, the annual report and the summary financial statements are sent by post to all shareholders along with the notice of the forthcoming Annual General Meeting of the Bank. Further, the shareholders are advised to contact the Bank whenever they require any updated information regarding the Bank or its operations.

The Bank also displays official new releases on its website https://www.nbo.om/en/Pages/News/Home.aspx for the shareholders, analysts and investors.

## Distribution of Dividends

The distribution of dividends to the shareholders by the Bank during the last five years appears in the table below:

### Table (10)

| Year | Cash dividend | Bonus shares |
|---|---|---|
| 2014 | 17% | 10% |
| 2015 | 17% | 10% |
| 2016 | 15.92% | 5% |
| 2017 | 15% | 5% |
| 2018 | 16% (recommended by the Board and subject to shareholders and regulatory approvals) | 0% |

During the year 2018, the Bank distributed donations to the charitable organizations and other non-profitable organizations and participated in CSR initiatives totaling RO 323,901.824 which is within the budget limit of RO. 324,500.000 approved by the Annual General Meeting held on 25th March 2018.

Details of NBO main donations and CSR initiatives during the year 2018:

### 1. Ministry of Social Development International Disabled Day

The Ministry of Social Development, planned a celebration for International Disabled Day.
(Actual spent – OMR 3,000/-).

### 2. NBO's 48th National Day Celebrations

We marked Oman's 48th National Day by organizing a special celebration at our Head Office and recording the entire event which was published on our social media pages.
(Actual spent – OMR 5,503/-).

### 3. NBO's Scholarships Program

To mark our 45th National Day Celebrations, NBO's Chairman announced the launch of a unique scholarship programme, enabling 15 students from low-income families to complete their undergraduate degrees at the top Universities in the UK.

Two scholarships have been awarded in 2018 to scholars that have just graduated from the Sultan's School (from low-income families).
(Actual spent – OMR 159,245.462/-).

### 4. Shahr Al Attaa

To engage with the community and support low-income families ahead of the holy month of Ramadhan, NBO's staff will distribute food hampers to over 1,200 families across the Sultanate.
(Actual spent – OMR 24,311.465/-).





### 5. NBO Hackathon

Given the successful launch of the first of it's kind Hackathon in the Sultanate in 2017, the second edition of NBO's hackathon in 2018 saw even bigger success with over 450 registrations of students, professionals and innovators from across the Sultanate and Region.
(Actual spent – OMR 37,950.222/-).

### 6. Women@NBO

The objective of the program is to inspire Women@NBO to achieve personal & professional fulfilment, and to empower them to unlock their full potential. The event was piloted internally and now has been extended to the public.
(Actual spent – OMR 10,808.875/-).

### 7. Tawasel

The series was created by young Omanis to address social challenges in a comedic and relatable way. The series first launched in February 2017, and was focused on social media related issues, and has gained massive popularity since then, it has had 2 million views on YouTube and over 200K views on Oman TV. This year the creators of the show focused on different social challenges, and have dedicated a full episode to encourage a funds saving culture and responsible banking.
(Actual spent – OMR 12,000/-).

### 8. Oman Historical and International Maps

The exhibition showcased between 80 to 100 maps, and is aimed at spreading knowledge of Oman's deep rooted history.
(Actual spent – OMR 10,000/-).

### 9. MOHE Breast Cancer Awareness

The Ministry of Higher Education, had a Breast Cancer Awareness event for High School students, to spread awareness on early detection and treatment.
(Actual spent – OMR 2,000/-).

### 10. Supporting Local Talent - Ahmed Al Harthy

NBO continues to support local talent who are promoting Oman globally.
(Actual spent – OMR 10,000/-).

### 11. Muscat & Khareef Festival

The festivals seek to promote Tourism in the Sultanate. We supported the Muscat Festival in January 2018 and the Khareef Festival in July 2018.
(Actual spent – OMR 15,000/-).

### 12. First Sustainability Conference

The conference's objective was, to publicize the concept and importance of sustainability in a business environment as well as emphasize the importance of reporting and disclosure in line with global practices.
(Actual spent – OMR 5,000/-).

### 13. BizPro Forum

The forum's objective was to bring leaders in government & business together to discuss strategies & policies to support business growth.
(Actual spent – OMR 5,000/-).

### 14. Innovation in SME Awards

To inspire the conceptualization and development of new business ideas amongst Oman's youth and to encourage the transformation of these ideas into businesses/SMEs with robust and sustainable business plans and strategies.

Five short-listed candidates presented their ideas to a panel of four judges in the form of a business. The winning idea was selected based on a number of criteria, namely: the quality of the business plan/idea, its uniqueness & USP, sustainability & feasibility and its potential for success.

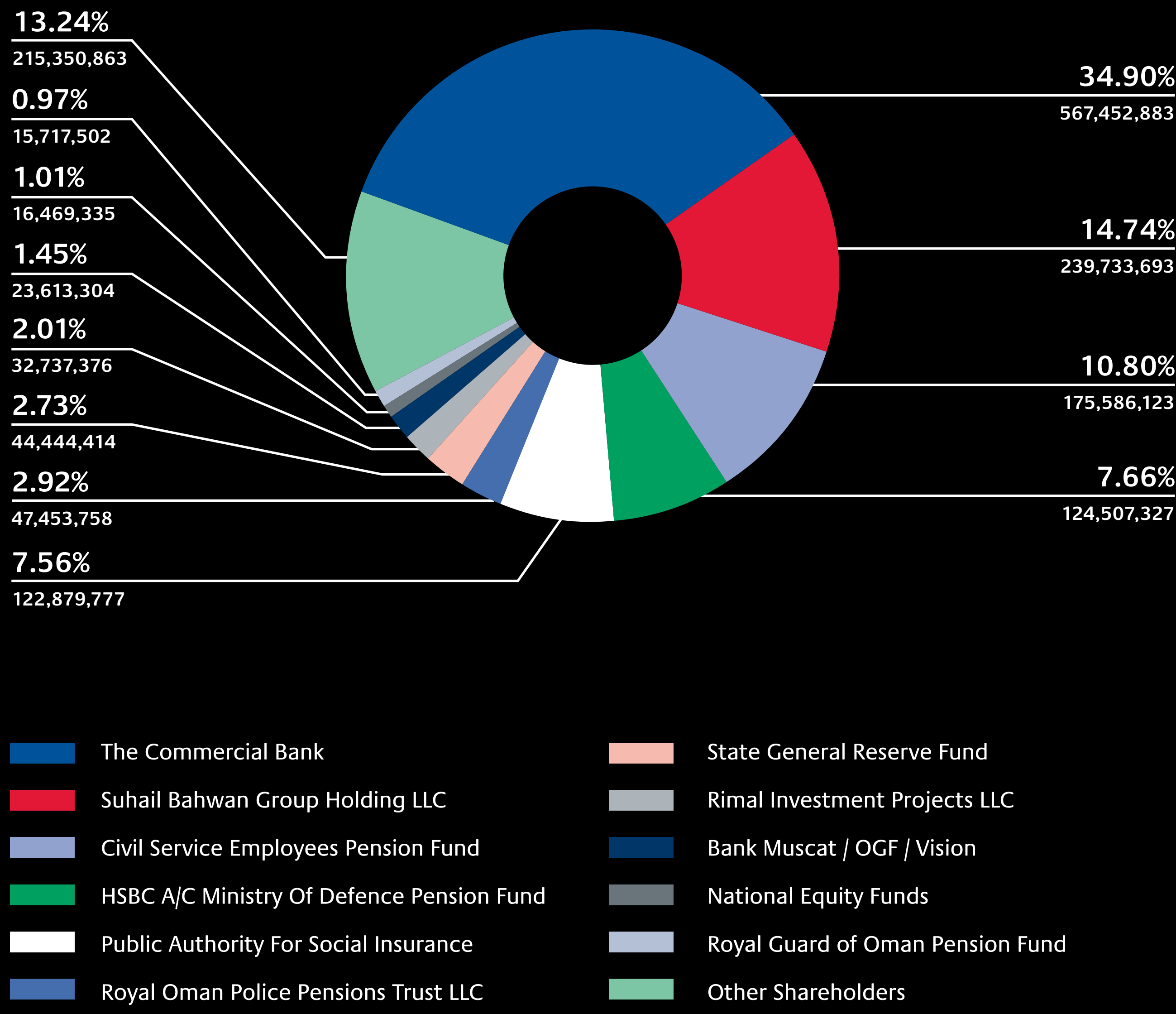
A OMR 10K cash prize was awarded to the most innovative and commercially-promising business idea, a cash prize of OMR 5K was awarded to the second place winners and a cash prize of OMR 2.5K to the 3rd place winners. The winners will join NBO's Tijarati SME mentoring program and will have access to the Bank's Academy of Excellence, NBO's network of corporate clients & will be recognized publicly.
(Actual spent – OMR 24,082.800/-).




Corporate Governance Report – 2018
Corporate Social Responsibility (CSR)

## Distribution of Shareholding

**Major shareholders (1% and above)**



The shareholding pattern as on 31st December 2018 was:

### Table (13)

| Number of Shares | Number of Shareholders | Total Shares | % of Capital |
|---|---|---|---|
| 7,000,000 and above | 16 | 1,462,339,345 | 89.94% |
| 3,000,000 to 6,999,999 | 10 | 38,703,003 | 2.38% |
| 1,500,000 to 2,999,999 | 18 | 37,692,089 | 2.32% |
| 500,000 to 1,499,999 | 54 | 46,684,813 | 2.87% |
| 100,000 to 499,999 | 115 | 27,496,015 | 1.69% |
| Below 100,000 | 977 | 13,031,090 | 0.80% |
| **Total** | **1,190** | **1,625,946,355** | **100%** |

A copy of the Management Discussion and Analysis is circulated as part of the Annual Report.

There are no Global Depository Receipts / Warrants or any Convertible Instruments outstanding.

## Details of non-compliance

CBO circular BM 1134 and Annexure 4 of the Code of Corporate Governance require the Bank to provide details of non-compliance. This includes any penalties, strictures imposed on the Bank by the MSM / CMA or any statutory authority such as the CBO, on any matter related to capital markets, during the last three years (2016, 2017 and 2018). The Bank has identified the following amounts below paid during the last three years.

As of 2018, the Bank had complied with all relevant regulatory requirements in the last three years with the below exceptions as mentioned in the Central Bank of Oman's "CBO" Examination reports:

In the Examination 2017 report, the Bank was penalized OMR 8,000 for not considering CBO's prior approval on structured products and providing access to some of the Banks systems to outsourced contracts. The Bank had also been penalized OMR 10,000 for delay in responding to some customer requests and OMR 30,000 for delay to fulfil requirements of the payment system. Regulatory guidelines were not considered for impact analysis and recovering fees from some retail customers, which resulted in a penalty of OMR 8,000. Total penalties paid: OMR 56,000.

In the Examination 2016 report, the bank was penalized OMR 20,000 for not considering CBO guidelines while recovering charges from a few retail customers and for upgrading and declassifying loans for few cases. The CBO has also penalized the Bank for not prescribing any cut off amount for quarterly risk review of loans classification for OMR 3,600. The Bank had also not considered CBO's prior approval on employing outsourced staff which resulted in a penalty of OMR 10,000. Total penalties paid: OMR 33,600.

In the Examination 2015 report, the Bank had not fulfilled some of the guidelines from CBO and was penalized OMR 4,000.

## Auditors

Having strong internal and external auditors is recognized by the Board as part of sound corporate governance providing an independent and continuous assessment of the adequacy of, and compliance with, the Bank's established policies and procedures.



Corporate Governance Report – 2018

## ERNST & Young (E & Y) Profile

### Profile of Statutory Auditors

EY is a global leader in assurance, tax, transaction and advisory services. EY is committed to doing its part in building a better working world. The insights and quality services which EY delivers help build trust and confidence in the capital markets and in economies the world over.

The MENA practice of EY has been operating in the region since 1923 and employs over 7,000 professionals. EY has been operating in Oman since 1974 and is a leading professional services firm in the country. EY MENA forms part of EY's EMEIA practice, with over 4,600 partners and approximately 106,775 professionals. Globally, EY operates in more than 150 countries and employs 261,559 professionals in 700 offices. Please visit ey.com for more information about EY.

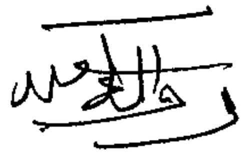
EY in Oman is accredited by the Capital Market Authority (CMA) to audit joint stock companies (SAOGs). During the year 2018, EY billed an amount of RO 185,668 towards professional services rendered to the Company (RO 166,000 for audit and RO 19,668 for tax and other services).

## Declaration

The Board of Directors declares its liability for preparation of the financial statements in accordance with the applicable standards and rules.

For the year under review the Board has conducted a review of the effectiveness of the Bank's internal control policies and procedures and is satisfied that the Bank's internal control are effective and that appropriate procedures are in place to implement the Code's requirements.

The Board of Directors confirms that there are no material issues that affect the continuation of the Bank and its ability to continue its operations during the next financial year.



**Rawan bint Ahmed Al Said**
Chairperson of the Board of Directors

# Basel II and III - Pillar III Report 2018

EY
Building a better working world

Ernst & Young LLC
P.O. Box 1750, Ruwi 112
5th Floor, Landmark Building
Opposite Al Ameen Mosque
Bowsher, Muscat
Sultanate of Oman

Tel: +968 22 504 559
Fax: +968 22 060 810
muscat@om.ey.com
ey.com/mena
C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

**REPORT ON FACTUAL FINDINGS TO THE BOARD OF DIRECTORS OF NATIONAL BANK OF OMAN SAOG IN RESPECT OF BASEL II - PILLAR III AND BASEL III RELATED DISCLOSURES**

We have performed the procedures agreed with you and as prescribed in the Central Bank of Oman's (CBO) circular No. BM 1027 dated 4 December 2007 with respect to the Basel II - Pillar III Disclosures and Basel III related Disclosures (the disclosures) of National Bank of Oman SAOG ("the bank") as at and for the year ended 31 December 2018. The disclosures were prepared by the management in accordance with the CBO's Circular No. BM 1009 dated 13 September 2006, Circular No. BM 1027 dated 4 December 2007 and Circular number 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures, as set out in Circular No. BM 1027, were performed solely to assist you in evaluating the bank's compliance with the related disclosure requirements set out in CBO Circular No. BM 1009 dated 13 September 2006 and BM 1114 dated 17 November 2013.

We report our findings as follows:

Based on performance of the procedures detailed above, we found the disclosures free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disclosures.

Had we performed additional procedures or had we performed an audit or review of the disclosures in accordance with the International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the accompanying disclosures to be included in the bank's annual report for the year ended 31 December 2018 and does not extend to any financial statements of the bank taken as a whole or to any other reports of the bank.

Ernst & Young LLC

إرنست ويونغ ش م م
ERNST & YOUNG LLC
C.R. No. 1224013
P.O. Box 1750 - P.C. 112, Sultanate of Oman

10 March 2019
Muscat



## Capital Structure

The authorised share capital of the bank as at 31 December 2018 is 2,000,000,000 shares of RO 0.100 each.

The issued and paid up capital of the bank as at 31 December 2018 is 1,625,946,355 shares of RO 0.100 each.

The bank has assigned capital for operations in UAE and Egypt, amounts equivalent to RO 34.10 million and RO 19.25 million respectively. These amounts cannot be withdrawn without the approval of the Central Banks of the respective countries. In addition, within Oman, the bank has allocated RO 13.50 million of capital towards the Islamic banking window.

The bank's consolidated capital structure as at close of 31 December 2018, based on Central Bank of Oman's (CBO) guidelines is as follows:

| Elements of Capital | Amount in RO 000's |
|---|---|
| **Tier I Capital** | |
| **Local Banks** | |
| Paid-up capital | 162,595 |
| Share premium | 34,465 |
| Legal reserve | 54,198 |
| Subordinated debt reserve | 17,000 |
| Retained earnings* | 127,176 |
| **Common equity Tier 1 before regulatory adjustments** | **395,434** |
| **Deduction** | |
| Deferred tax asset | (734) |
| Revaluation reserves / Cumulative fair value losses on available for sale instruments | (5,730) |
| **Common equity Tier 1** | **388,970** |
| **Additional Tier 1 Capital** | |
| Tier 1 Perpetual Bond | 115,500 |
| **Tier II capital after all deductions** | **504,470** |
| **Tier II Capital** | |
| **Revaluation reserves / Cumulative fair value gains on available for sale instruments** | **409** |
| General loan loss provision / General loan loss reserve | 35,830 |
| **Total Tier II Capital** | **36,239** |
| **Total Regulatory Capital** | **540,709** |

**Note: Retained earnings are after deduction of RO 26.01 million towards proposed cash dividend, which is subject to CBO approvals and shareholders' approval in AGM.*

## Capital Adequacy

### Qualitative Disclosures:

The ultimate objectives of capital management are three fold:

- Ensure stability of the bank by holding enough capital to cover unexpected loss
- Enhance the efficiency of the bank, by increasing the risk adjusted return at various levels of aggregation (and thereby ensuring that "excess" capital is not held unnecessarily)
- Incentivize informed decision making and proactive risk management through an efficient and effective allocation of capital across the business.



Basel II and III – Pillar III Report 2018

## Capital Adequacy (continued)

The capital management plan envisaged for the bank is based on the regulatory risk capital framework of Basel II and using standardised approach for calculating the credit as well market risk and the basic indicator approach for operational risk as prescribed by CBO.

The capital management policy of the bank aims to ensure that on a risk adjusted return on capital basis (RAROC), individual lines of business are allocated an appropriate amount of capital. The RAROC model has been implemented for the entire portfolio except for Retail banking where the Central Bank of Oman has defined caps on interest rates, which are followed.

The Asset Liability Committee (ALCO) reviews and monitors capital adequacy and requirement for capital on an ongoing basis. Capital adequacy calculation is prepared and submitted for ALCO's review every month. Various stress scenarios, taking into account the earning volatility, credit and market risk impact along with capital allocation by line of business is reviewed in this forum.

### Qualitative Disclosures:

A set of triggers is followed as part of the capital management so as to provide the bank with an early warning system in terms of its level of capital, to enable it to take suitable measures at an early stage to prevent capital falling below acceptable limits.

The Bank prepares ICAAP (Internal Capital Adequacy Assessment Process) document in line with Basel II guidelines to evaluate all Enterprise-wide Risks that are not fully captured in the Pillar I Risks. This document addresses through objective and subjective evaluation, the adequacy of capital after considering the impact of additional risks, such as, Residual Credit Risk, Residual Credit Risk Mitigation (CRM) Risk, Residual Credit Risk–Equity, Residual Market Risk–Currency, Credit Concentration Risk, Interest Rate Risk in Banking Book, Settlement Risk, Reputation Risk, Strategic Risk and Compliance Risk as well as various levels of stress tests. Following the guidelines issued by the Central Bank of Oman in December 2012, assessment under ICAAP is carried out and submitted to the Central Bank of Oman in accordance with the prescribed guidelines. The bank will also factor in the regulatory guidelines, wherever applicable on Basel III, while carrying out its assessment.

Position as at 31.12.2018 (RO'000)

| Details | Amount in RO 000's |
|---|---|
| **Tier I capital (after supervisory deductions)** | **504,470** |
| **Tier II capital (after supervisory deductions & upto eligible limits)** | **36,239** |
| Tier III capital (upto a limit where Tier II & Tier III does not exceed Tier I) | - |
| Of which, total Eligible Tier III Capital | - |
| **Risk Weighted Assets (RWAs) – Banking Book** | **3,010,792** |
| **Risk Weighted Assets (RWAs) – Operational Risk** | **248,285** |
| **Total Risk Weighted Assets (RWAs) – Banking Book + Operational Risk** | **3,259,077** |
| Minimum required capital to support RWAs of Banking Book and Operational Risk | 419,606 |
| Minimum required capital comprises of; | |
| i) Tier I capital | 383,367 |
| ii) Tier II capital | 36,239 |
| Balance Tier I capital available for supporting Trading Book | 121,103 |
| Balance Tier II capital available for supporting Trading book | - |
| **Risk Weighted Assets (RWAs) – Trading Book** | **65,115** |
| Total capital required to support Trading Book | 8,384 |
| Minimum Tier I capital required for supporting Trading Book | 2,389 |
| **Total Regulatory Capital** | **540,709** |
| **Total Risk Weighted Assets – Whole bank** | **3,324,192** |
| **BIS Capital Adequacy Ratio** | **16.3** |

Basel II and III – Pillar III Report 2018

### Basel III Disclosures:

In compliance with CBO circular BM 1114 dated 17 November 2013; certain mandatory capital adequacy disclosures are made below:

Position as at 31.12.2018 (RO'000)

| Details | Gross balance (Book value) | Net balance (Book value) | Risk Weighted Assets |
|---|---|---|---|
| On balance sheet items | 3,675,289 | 3,532,342 | 2,761,395 |
| Off balance sheet items | 272,343 | 272,342 | 246,395 |
| Derivatives | 3,002 | 3,002 | 3,002 |
| Operational Risk | - | - | 248,285 |
| Market Risk | - | - | 65,115 |
| **Total** | **3,950,634** | **3,807,686** | **3,324,193** |
| Common equity Tier I Capital | - | - | 388,970 |
| Additional Tier 1 Capital | - | - | 115,500 |
| Tier 2 Capital | - | - | 36,239 |
| **Total Regulatory Capital** | - | - | **540,709** |
| Total required Capital @ 12.875% | - | - | 427,990 |
| Capital requirement for credit risk | - | - | 387,639 |
| Capital requirement for market risk | - | - | 8,384 |
| Capital requirement for operational risk. | - | - | 31,967 |
| **Common equity Tier 1 Ratio** | | | **11.7** |
| **Tier I Ratio** | - | - | **15.2** |
| **Total Capital ratio** | - | - | **16.3** |

# Risk Exposure and Assessment

## Risk Management

The primary objective of risk management is to safeguard the Bank's resources from the various risks which the Bank faces. The Risk Group comprises Corporate Credit Risk, SME Credit Risk, Retail Credit Risk, Market Risk, Operational Risk, Information Security and Business Continuity Risk and Loan Review section. All risk management functions report to Chief Risk Officer and are independent from Business Units.

The Bank's Credit Risk Strategy is aimed at adopting a structured approach to credit growth and de-emphasizing areas that are considered relatively high risk based on the prevailing and expected market conditions.

The administrative framework and the policies and procedures in place for the management of risks are based on international best practices, the recommendations of the Basel Committee and the guidelines of the Central Bank of Oman.

The Bank has exposure to the following risks:

## Credit Risk

### Qualitative Disclosures

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fail to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investment securities. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

The Bank manages and controls credit risk by setting internal limits on the amount of risk it is willing to accept for individual counterparties and groups (single obligors) and industry sectors in line with the guidelines of Central Bank of Oman. The Bank computes expected losses on credit exposure on the basis of risk classification of both corporate and retail loans in the delinquent category based on the guidelines of Central Bank of Oman. The objective of the Bank in management of credit risk is to protect the credit quality of its credit exposures. Credit Risk is managed within the regulatory requirement of Central Bank of Oman, risk framework provided in the Risk Charter and Credit Policies and Procedures.

## Credit Risk (continued)

The policies and procedures are periodically reviewed by the Management and the Board Risk Committee to ensure alignment to the current best practices. Credit exposures are approved by delegated authorities based on delegation by the Board and Board Risk Committee. The delegation of authorities is based on the size of the single obligor exposure, the credit quality (internal, external rating) as well as level of credit risk mitigation (collateral, guarantees, etc.) for the proposed exposures. For retail exposures, there is delegation of authority for handling exceptions to approved program lending. Control, monitoring and management of credit exposures are done in coordination with respective Business Units as per established procedures.

The Bank has in place a robust credit risk management structure comprised of Corporate Credit Risk, SME credit risk, Retail Credit Risk, Loan Review Mechanism, Remedial Management and Credit Administration and Control Divisions.

### Corporate Credit Risk and SME Credit Risk:

Corporate Credit Risk Division is responsible for independent assessment and control of the risks related to all Corporate Banking and Financial Institutions exposures while SME Credit Risk Division independently reviews Business Banking and Small Business Unit exposures. Both the Division reviews and assesses credit risk for proposed exposures prior to facilities being committed to customers by the concerned business units. Renewals and reviews of facilities are subject to the same process. Each proposal is also assessed with respect to established concentration limits for various economic sectors, countries, risk grades, etc. and deviations, if any are highlighted. The bank follows risk based pricing and each credit proposal is also assessed based on internal benchmarks of required risk adjusted returns. The bank has implemented a customized Moody's Risk Analyst model for risk rating corporate borrowers. Corporate Credit Risk Division also provides advice and guidance to business units with a view to promoting best practices throughout the bank in the management of credit risk.

In addition to formal annual credit risk reviews of each corporate facility, more frequent reviews are also undertaken for watch list accounts, public companies and large exposures. Further, the bank continues to undertake quarterly review of financial institutions and country portfolio including stress tests and review of adverse rating migrations and outlooks in line with best practices and regulatory guidelines.

### Retail Credit Risk

Retail Credit Division manages the credit risk in the retail portfolio. Credit facilities are offered to retail customers primarily based on Product Programs. A programmed lending approach contains standard risk acceptance criteria and loan processing practices in order to optimize the efficiency and risk / reward of those portfolios. Product programs are approved by Board Risk Committee and their performance is monitored on a regular basis and reviewed.

Based on the prevailing market conditions, the Bank sustained its continuous monitoring of the portfolio with a thorough review of the Credit Policy / Product Program. Credit facilities outside the Product Programs / Policy Parameters are individually reviewed and assessed by the Retail Banking division & the Retail Credit Risk Division.

Several system enhancements and new processes have been introduced across critical activities to improve processing quality and efficiency and to enhance the recovery methodologies of the retail portfolio. The Bank has an automated Loan Collection System in order to enhance its collections and recovery processes. It also has an automated Loan Origination System to further enhance its Retail Credit Risk framework.

### Loan Review Mechanism

An independent Loan Review Mechanism Division evaluates the quality of loan book, balance between risk and reward and brings about qualitative improvements in credit administration. The division evaluates effectiveness of loan administration, integrity of credit grading process, assessment of expected credit losses, portfolio quality, etc.

### Remedial Management:

Remedial Management is responsible for pursuing each delinquent account, by using all available measures, to reduce exposure to high risk groups, to maximize recoveries, rehabilitating these relationships so that they can be returned to the business lines as fully performing accounts and progressively improve the status of the portfolio.

### Credit Administration and Control:

The Credit Administration and Control section ensures:

- Documentation for all loans is properly completed, executed and maintained.
- The correct approving authority approves credit lines and details are accurately recorded.
- Production of adequate and accurate reports covering various credit risk exposures.
- Irregularities are reported and corrective action is taken.
- Review of and participation in any new/existing product offerings of the Bank.
- Various internal reporting and external reporting is prepared on a periodical basis.
- That all approved limits are input into the system under a "maker and checker" concept.

Basel II and III – Pillar III Report 2018

## Credit Risk (continued)

- Disbursement of funds for all approved credit exposures is appropriately authorized.

**Risk Reporting and Measurement Systems**

The scope and nature of the risk reporting and/or measurement system are as follows:

Risk Reporting

A comprehensive review of the Corporate Credit Portfolio is conducted on a quarterly basis and provided to the Senior Management and the Risk Committee of the Board. Salient areas covered in the review include:

- Exposures downgraded/negatively migrated
- Weighted average credit grade profile
- Portfolio concentration/ performance
- Position of restructured exposures
- Position of past due exposures
- Exposures secured by equity
- Exposures to real estate and leasing sectors
- Syndicated exposures
- New relationships
- Exposures to senior members and non-resident borrowers
- Exposures to countries / financial institutions

In addition, the bank conducts industry studies in various sectors considered to have a bearing on the portfolio credit quality, such as, real estate, leasing, and sectors impacted by volatility in commodity prices. For FIG exposures the bank conducts stress tests and quarterly reviews of adverse rating migrations and outlooks in line with best practices and regulatory guidelines. These reports are reviewed periodically by the Management and Board Risk Committees.

A review of the Retail Credit Portfolio is conducted on a monthly basis and provided to the Management Risk Committee, and every quarter the latest report is presented to the Board Risk Committee. Salient areas covered in the review include:

- Portfolio review
- Management summary, delinquency and default trends (including product-wise delinquency analysis, vintage analysis, delinquencies across various credit criteria, etc.)
- Projects undertaken / fulfilled during the month
- Recoveries

**Measurement:**

**Impairment losses on loans and advances:**

The bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in the statement of comprehensive income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the bank makes judgments about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.) and concentrations of risks.

**Definition of default and cure**

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Bank
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection • Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties

## Credit Risk (continued)

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

**Incorporation of forward-looking information**

The bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on consideration of a variety of external actual and forecast information, the bank formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

Given the nature of the bank's exposures and availability of historical statistically reliable information, the bank derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Moody's for each rating category.

**Economic variable assumptions**

The method applied for determination of macroeconomic scenarios and their probabilities is a hybrid approach that combines deterministic forecast / modelling with analysis of stochastic distribution to get the alternative economic conditions and their probabilities.

The major assumptions and methodological choices can be summarised in a following set of steps:

1. Despite the fact that oil price was not chosen as an explanatory variable during statistical optimisation of variable selection, the business acumen as well as correlation analysis suggest that it is a major driving force in determination of GDP and real interest rate as defined by the World Bank (GDP deflator is highly affected by oil price as oil manufacturing is responsible for a vast portion of GDP volume in Oman)
2. The base scenario was created on the assumption of stabilisation of oil price at the level of 54 USD/barrel for Brent oil.
3. The alternative scenarios were constructed based on deviations from the base trajectory of oil price taking into account:
    a. historical volatility of changes in oil prices (28% standard deviation of annual relative price changes),
    b. size of the detachment equal to plus/minus 0,87 standard deviation from the base scenario as an approximate representation of 33,33% probability of alternative (adverse and favourable) scenarios,
    c. the time dynamics of the variable was based on assumption of normal distribution of annual changes of oil prices with some mean reverting characteristics and respective time scaling (standard deviation times square root of time) with the signs (-/+) in line with the character of the scenario (adverse / favourable).
4. GDP and real interest rate were forecasted deterministically based on their reciprocal dependencies and their relationship (with appropriate time lags) to oil price changes assuming mid-prices of Brent oil under given scenario as obtained through the process described in 3.
5. GDP per capita was predicted through regression to corresponding GDP changes as estimated for a given scenario and assumed lowering pace of population growth not dependent on the scenario in question.

Treasury, trading and interbank relationships

The Bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank's credit risk department analyses publicly available information such as financial information and other external data and assigns the internal rating.

Corporate and small business lending

For corporate and investment banking loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.

Basel II and III – Pillar III Report 2018

## Credit Risk (continued)

- The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and retail mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing

**Exposure at default**

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

**Loss given default**

For corporate and investment banking financial instruments, LGD values are assessed at least every twelve months by account managers and reviewed and approved by the Bank's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics. Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the bank.

The Bank estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI IFRS 9 segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. In certain cases, the Bank may also consider that events set out below are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

a. Inadequate or unreliable financial or other information such as unavailability of audited financial statements within 120 days from end of accounting period.
b. Delay in documentation execution over 35 days from limit set up due to disputes with customers.
c. Borrower is subject to litigation by third parties that may have a significant impact on his financial position.
d. Frequent changes in key senior management personnel without acceptable successors or professional management.
e. Intra Group transfer of funds without underlying transactions beyond 50% of Tangible Net Worth.
f. Deferment/delay in the date for commencement of commercial operations by more than one year



## Credit Risk (continued)

except in Government projects or delays are due to Government approvals.

g. Modifications of terms resulting in concessions granted to the borrower (after examining the cash flows of the borrower / financial position / ability to repay) including extension of moratorium, deferment of payment, waiver of covenants etc. This requirement shall be in conformity to the restructuring guidelines issued by CBO from time to time.
h. A fall of 25% or more in the turnover or in the EBIT as compared to the previous year except in the case of change in business model / one of material events.
i. A fall in Debt Service coverage ratio to below 1 except in cases which have acceptable external credit support.
j. Rating downgrade by 3 notches for ratings from R1 to R4 and 2 notches downgrade for R5 and R6.
k. Erosion in net worth by more than 20% compared to previous year coupled with increase in leverage by 1.5 times.

**Model risk management:**

The bank has utilised models in many of its financial and business activities from underwriting a credit facility to reporting expected loss under the IFRS9 accounting standards.

To manage the model risks, the bank has implemented the IFRS 9 Governance Framework (the Framework). The Framework is a bank wide policy and is applicable to all models of the bank. According to the Framework, all internally or externally (vendor based) developed risk quantification models that directly affect the financial reporting on Expected Loss (EL) and Lifetime Expected Loss (LEL) require independent validation.

The Framework establishes a systematic approach to manage the development, validation, approval, implementation and on-going use of the models. It sets out an effective management structure with clearly defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international practices. Any major change to the Framework must be approved by the Board of Directors or the BRC.

The bank has a practice of doing independent model validation which provides recommendation to approve the use of the new risk quantification / valuation models. In addition to new model validation, it also evaluates the performance of existing models through an annual validation process. The independency of the team will serve as an effective second line of defense for the bank in terms of usage of models.

**Credit Risk Management Policy:**

A comprehensive set of Corporate Credit Risk Policy and Procedures Manuals, provides detailed policy guidelines and embedded in which are the regulatory/ in-house limits. Further, procedures manuals provide detailed process guidelines about the credit process and the templates to be used to process the individual credit applications. Financial Institutions Group (FIG ) exposures are managed as per the Financial Institutions Policy guidelines. Retail Credit Policy outlines the policy guidelines related to retail banking and covers product programs and parameters relating to Salary Related Loans, Mortgages, Credit Cards and other retail product offerings. Credit Policies and Procedures are periodically reviewed to ensure that they are aligned to the market and regulatory guidelines.

**Quantitative Disclosure**

(i) Total gross credit exposures, plus daily average of gross exposure over the period broken down by major types of credit exposure as at 31 December 2018:

| Sl No. | Type of Credit Exposure | Average Gross Exposure | | Total Gross Exposure as at | |
|---|---|---|---|---|---|
| | | Current Year | Previous Year | 31 December 2018 | 31 December 2017 |
| 1 | Overdrafts | 97,559 | 73,214 | 99,724 | 99,990 |
| 2 | Personal loans | 1,370,008 | 1,305,317 | 1,401,890 | 1,360,285 |
| 3 | Loans against trust receipts | 62,821 | 112,650 | 49,227 | 58,830 |
| 4 | Other loans | 1,217,763 | 1,241,257 | 1,363,321 | 1,210,774 |
| 5 | Bills purchased / discounted | 29,609 | 65,085 | 25,923 | 40,523 |
| | **Total** | **2,777,760** | **2,797,523** | **2,940,085** | **2,770,402** |

Basel II and III – Pillar III Report 2018

## Credit Risk (continued)

(ii) Geographic distribution of exposures by major types of credit exposure as at 31 December 2018:

(RO'000)

| Sl No. | Type of Credit Exposure | Oman | Other GCC countries | Others | Total |
|---|---|---|---|---|---|
| 1 | Overdrafts | 84,701 | 15,014 | 9 | 99,724 |
| 2 | Personal loans | 1,401,203 | 548 | 139 | 1,401,890 |
| 3 | Loans against trust receipts | 47,718 | 1,509 | - | 49,227 |
| 4 | Other loans | 1,255,756 | 101,402 | 6,163 | 1,363,321 |
| 5 | Bills purchased / discounted | 23,787 | 2,136 | - | 25,923 |
| | **Total** | **2,813,165** | **120,609** | **6,311** | **2,940,085** |

(iii) Industry or counter party type distribution of exposures, broken down by major types of credit exposure as at 31 December 2018:

(RO'000)

| S. No | Economic Sector | Overdraft | Loans | Bills Purchased / Discounted | Others | Gross Total | Off Balance Sheet Exposure |
|---|---|---|---|---|---|---|---|
| 1 | Import Trade | - | 12,747 | - | 35,302 | 48,049 | - |
| 2 | Export Trade | - | - | - | - | - | - |
| 3 | Wholesale & Retail Trade | 16,987 | 168,541 | 4,784 | 3,821 | 194,133 | 61,405 |
| 4 | Mining & Quarrying | 1,374 | 70,762 | 3,619 | - | 75,755 | 3,078 |
| 5 | Construction | 31,219 | 136,618 | 12,466 | 8,763 | 189,066 | 192,743 |
| 6 | Manufacturing | 11,384 | 197,878 | 2,223 | 432 | 211,917 | 50,018 |
| 7 | Electricity, gas and water | 667 | 119,879 | 111 | - | 120,657 | 617 |
| 8 | Transport and Communication | 1,389 | 93,143 | 99 | 452 | 95,083 | 30,091 |
| 9 | Financial Institutions | 3,066 | 254,357 | - | 8 | 257,431 | 52,480 |
| 10 | Services | 11,497 | 214,209 | 1,696 | 414 | 227,816 | 16,375 |
| 11 | Personal Loans | - | 1,401,890 | - | - | 1,401,890 | 250 |
| 12 | Agriculture and Allied Activities | 838 | 4,278 | 83 | 35 | 5,234 | 101 |
| 13 | Government | 199 | - | - | - | 199 | - |
| 14 | Non-Resident Lending | - | 17,189 | - | - | 17,189 | - |
| 15 | All Others | 21,104 | 73,720 | 842 | - | 95,666 | 62,544 |
| | **Total** | **99,724** | **2,765,211** | **25,923** | **49,227** | **2,940,085** | **469,701** |

## Credit Risk (continued)

(iv) Residual contractual maturity as at 31 December 2018 of the whole loan portfolio, broken down by major types of credit exposure:

(RO'000)

| S. No | Time Band | Overdraft | Loans | Bills Purchased/ Discounted | Others | Total | Off Balance Sheet Exposure |
|---|---|---|---|---|---|---|---|
| 1 | Up to 1 month | 4,986 | 136,357 | 12,243 | 19,231 | 172,817 | 100,593 |
| 2 | 1 - 3 months | 4,986 | 235,617 | 10,220 | 16,079 | 266,902 | 174,948 |
| 3 | 3 - 6 months | 4,986 | 67,138 | 3,460 | 13,286 | 88,870 | 41,191 |
| 4 | 6 - 9 months | 4,986 | 45,007 | - | 631 | 50,624 | 47,475 |
| 5 | 9 - 12 months | 4,987 | 188,043 | - | - | 193,030 | 31,923 |
| 6 | 1 - 3 years | 24,931 | 329,838 | - | - | 354,769 | 70,651 |
| 7 | 3 - 5 years | 24,931 | 259,787 | - | - | 284,718 | 2,645 |
| 8 | Over 5 years | 24,931 | 1,503,424 | - | - | 1,528,355 | 277 |
| | **Total** | **99,724** | **2,765,211** | **25,923** | **49,227** | **2,940,085** | **469,701** |

(v) Total loan broken down by major industry or counter party type as at 31 December 2018:

| S. No | Economic Sector | Gross Loans | Of which, NPL as per IFRS-9 | Stage-1 and stage-2 prov as per IFRS-9 | Stage-3 prov held as per IFRS-9 | Provisions made during the year | Advances written off during the year |
|---|---|---|---|---|---|---|---|
| 1 | Import Trade | 48,049 | - | 1,641 | - | - | - |
| 2 | Export Trade | - | - | - | - | - | - |
| 3 | Wholesale & Retail Trade | 194,133 | 30,262 | 3,118 | 21,553 | 2,978 | - |
| 4 | Mining & Quarrying | 75,755 | 353 | 2,210 | 353 | 225 | 74 |
| 5 | Construction | 189,066 | 9,219 | 11,610 | 12,930 | 11,042 | 10 |
| 6 | Manufacturing | 211,916 | 21,975 | 2,858 | 12,644 | 240 | 16,700 |
| 7 | Electricity, gas and water | 120,657 | 56 | 360 | 56 | 60 | - |
| 8 | Transport and Communication | 95,083 | 3,595 | 1,428 | 3,484 | 612 | - |
| 9 | Financial Institutions | 257,431 | - | 368 | - | | - |
| 10 | Services | 227,816 | 35,494 | 3,407 | 19,290 | 659 | 23 |
| 11 | Personal Loans | 1,401,883 | 33,160 | 17,844 | 12,731 | 2,520 | 6,291 |
| 12 | Agriculture and Allied Activities | 5,234 | 1,369 | 36 | 1,140 | 17 | - |
| 13 | Government | 199 | - | 15 | - | - | - |
| 14 | Non-Resident Lending | 17,189 | - | 49 | - | - | - |
| 15 | All Others | 95,674 | 5,036 | 5,648 | 5,798 | 1 | 321 |
| | **Total** | **2,940,085** | **140,519** | **50,591** | **89,979** | **18,356** | **23,419** |

## Credit Risk (continued)

(vi) Amount of impaired loans as at 31 December 2018, broken down by significant geographical areas including, with the amounts of specific and general allowances related to each geographical area:

| S. No | Geographic Sector | Gross Loans | Of which, NPL as per IFRS-9 | Stage -1 and stage-2 prov as per IFRS-9 | Stage-3 prov held as per IFRS-9 | Provisions made during the year | Advances written off during the year |
|---|---|---|---|---|---|---|---|
| 1 | Oman | 2,813,165 | 82,387 | 49,906 | 44,677 | 8,753 | 21,822 |
| 2 | Other GCC Countries | 120,609 | 57,983 | 683 | 45,156 | 9,603 | 1,598 |
| 3 | Others | 6,311 | 148 | 2 | 147 | - | - |
| | **Total** | **2,940,085** | **140,519** | **50,591** | **89,979** | **18,356** | **23,419** |

(vii) Movement of gross loans

| S. No | Details | Stage 1 | Stage 2 | Stage 3 | Total |
|---|---|---|---|---|---|
| 1 | Opening balance | 1,855,142 | 802,331 | 112,929 | 2,770,402 |
| 2 | Migration / changes (+/-) | 7,001 | (59,799) | 52,798 | - |
| 3 | New loans | 864,556 | (23,857) | 6,703 | 847,402 |
| 4 | Recovery of loans | 462,364 | 183,444 | 8,492 | 654,300 |
| 5 | Loans written off | - | - | 23,419 | 23,419 |
| 6 | **Closing balance** | **2,264,335** | **535,231** | **140,519** | **2,940,085** |
| 7 | Total Provisions | **16,947** | **33,646** | **89,979** | **140,573** |

**Credit Risk –Disclosures for portfolios subject to the standardized approach.**

**Qualitative Disclosures:**

- The bank is following Moody's rating for both sovereign and interbank exposures and the balance is treated as unrated at 100% risk.
- With the approval of the CBO, the bank uses the discretion to treat loans and advances as unrated at risk weight of 100%, except housing loans which are risk weighted at 35% based on the requirements as stipulated in the guidelines issued by CBO.
- Similarly, with the approval of CBO, the bank uses the discretion of the simple approach for recognising collaterals.





## Credit Risk (continued)

Quantitative Disclosures:

Gross exposure amount as at 31 December 2018, subject to the standardized approach is as below:

| Sr No | Product / Rating | Carrying 0% | Carrying 20% | Carrying 35% | Carrying 50% | Carrying 100% | Carrying 150% | Total |
|---|---|---|---|---|---|---|---|---|
| | **Rated** | | | | | | | |
| 1 | Sovereign | 443,326 | - | - | - | 1,979 | - | 445,305 |
| 2 | Banks | - | 44,887 | - | 32,117 | 24,103 | - | 101,106 |
| | **Unrated** | - | | - | - | - | - | |
| 1 | Corporate | - | 9,578 | - | - | 1,233,928 | - | 1,243,506 |
| 2 | Retail | - | - | - | - | 942,718 | - | 942,718 |
| 3 | Claims secured by residential property | - | - | 323,907 | - | 102,105 | - | 426,013 |
| 4 | Claims secured by commercial property | - | - | - | - | 185,200 | - | 185,200 |
| 5 | Past due loans | - | - | - | - | 139,266 | - | 139,266 |
| 6 | Other assets | 57,039 | 956 | - | - | 133,476 | 410 | 191,880 |
| 7 | Venture Capital & Private Equity Investments | - | - | - | - | | 295 | 295 |
| 8 | Off-balance Sheet Items | 10,636 | 9,028 | - | 16,177 | 239,503 | - | 275,343 |
| | **Total Banking Book** | **511,001** | **64,449** | **323,907** | **48,294** | **3,002,278** | **705** | **3,950,633** |

## Credit Risk Mitigation

Qualitative Disclosures:

The bank holds collateral against loans and advances to customers in the form of cash, government development bonds, acceptable financial securities, mortgage interest over property, and other registered charge over assets, and guarantees. Estimates of fair value are based on the value of the collateral assessed on an on-going basis.

The Bank has adopted the simple approach for collaterals.

Quantitative Disclosures:

(RO'000)

| Sr No | Details | Amount |
|---|---|---|
| 1 | Corporate Cash Collateral | 52,968 |
| 2 | Specific provisions and reserve interest on loans and advances and due from banks | 89,979 |
| | **Total** | **142,947** |

The capital requirement on credit risk as at 31 December 2018 is RO ('000) 387,639

Basel II and III – Pillar III Report 2018

## Market Risk

The objective of Bank's Market Risk Management is to manage and control market risk exposures which arises from fluctuations in interest rates, foreign exchange rates and equity prices while maintaining a market profile consistent with Bank's risk appetite. The board has set limits for acceptable levels of Market Risk. The Assets and Liabilities Committee (ALCO) monitors the exposure on a regular basis. Market Risk is managed based on Central Bank of Oman guidelines and the Market Risk Policy, which is approved and periodically reviewed by the Board Risk Committee. Separate Market Risk policies exist for the Bank's operations in Egypt and UAE to be compatible with the local regulatory and operational environments. Stress tests are also conducted periodically to analyze the impact of Bank and market specific stress factors crises on the earnings and capital of the Bank. The results are reviewed by ALCO, Management and Board Committees.

Market Risk Division provides risk-weightings for treasury products in line with best practices based on potential future exposure. The middle-office along with Treasury and Investment Banking Operations monitors the Market Risk positions of the Bank.

## Trading Book

Foreign Exchange Risk is the risk that the Bank may suffer losses as a result of adverse exchange rate movements.

The exposure under the trading book of the Bank includes relatively small foreign exchange exposure primarily arising from the holding of day-end positions in currencies overnight, and exposure towards interest rate related instruments. Positions are monitored on daily basis to ensure open currency position is maintained within the regulatory limit of 40% of networth.

Value-at-risk (VaR) is used to estimate the potential losses on risk positions as a result of movements in market rates and prices. The VaR is computed every month for all non-pegged currencies in which the Bank's end-of-the-day position is above a minimum threshold. The VaR is reviewed by ALCO, Management Risk Committee and Board Risk Committee.

The Bank holds investment that are Fair Value Through Profit and Loss account (FVTPL) consisting of investments in portfolio of equities and funds which is managed by the Investment Banking division. The exposures are daily monitored by the Middle Office as per the approved stop loss and exposure limits through Mark-to-Market (MTM) reports.

For the purpose of capital charge, the three month average of the sum of the net short positions or net long positions, whichever is higher, is taken. The average is worked out on the basis of the actual positions as obtained on all the working days during the three month period immediately preceding the reporting date. The capital charge is computed at 12.825% to reflect the general market risk.

Capital required for trading book as at 31 December 2018:

- Foreign Exchange Risk - RO ('000) 8,384

### Banking book

## Equity Price Risk

The proprietary equity positions are held in the Fair Value Through Other Comprehensive Income (FVOCI) category as part of Banking book exposure and not in the FVTPL category. As such, no VaR is calculated for the FVOCI portfolio. These are marked to market on a daily basis which are circulated to the management and required actions, if any, are promptly taken as per the investment Policy, which inter-alia provides sector concentration limits, trigger levels and other guidelines for prudent management of the portfolio.

## Interest Rate Risk

The principal market risk to which non-trading portfolio is exposed is the risk of loss from fluctuation in the future cash flows or fair values of financial instruments because of changes in market interest rates. Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities.

Interest rate risk is managed by monitoring the sensitivity of the Bank's financial assets and liabilities to various standard interest rate scenarios. Standard scenarios that are considered on a monthly basis include a 200 basis point (bp) parallel fall or rise in yield curves to review the impact on the economic value of the assets and liabilities and the equity of the Bank and impact on the earnings of the Bank up to one year.

In respect of monitoring the impact of interest rate changes on the earnings of the Bank, the Bank has set internal limits. Positions are monitored on a monthly basis and hedging strategies used to ensure positions are maintained within established limits.

The methods for interest rate sensitivity analysis are a traditional Maturity Gap Analysis (to measure the interest rate sensitivity of earnings), and duration (to measure interest rate sensitivity of capital) as per methodology provided by Basel Committee in 2004.

## Interest Rate Risk (continued)

Quantitative Disclosures:

The assumptions used to measure the sensitivity is parallel shift in interest rate by 200 basis points (bps) to measure the interest sensitivity of earnings and interest rate sensitivity of capital.

| As at December 2018 | 200 bps increase | 200 bps decrease |
|---|---|---|
| **Earnings impact - RO'000s** | **8,121** | **(8,121)** |
| **Earnings impact - USD'000s** | **21,094** | **(21,094)** |

The bank has been consistently using the above methods / assumptions to conduct interest rate sensitivity analysis. The analysis is carried out at monthly rests and results thereof monitored against the in-house prescribed limits; the results are also actively deliberated at the ALCO meetings. The interest rate risk of the Bank have been within the prescribed limit during the year.

The bank's interest sensitivity position, in line with guidelines issued by Central bank of Oman, based on contractual re-pricing arrangements at 31 December 2018 was as follows:

| | Average effective interest rate | On demand within 3 months RO'000 | 3 to 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Non-interest sensitive RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | N/A | - | - | - | - | 315,055 | 315,055 |
| Due from banks and other money market placements (net) | 2.93% | 51,732 | 18,287 | - | - | 28,045 | 98,064 |
| Loans, advances and financing activities for customers (net) | 5.50% | 913,367 | 634,858 | 644,981 | 614,141 | 2,360 | 2,809,707 |
| Financial investments | 4.50% | 25,961 | - | 71,727 | 105,173 | 28,288 | 231,149 |
| Premises and equipment | N/A | - | - | - | - | 64,360 | 64,360 |
| Other assets | N/A | - | - | - | - | 54,587 | 54,587 |
| **Total assets** | | **991,060** | **653,145** | **716,708** | **719,314** | **492,695** | **3,572,922** |
| Due to banks and other money market deposits | 8.34% | 146,536 | 3,850 | - | - | 5,563 | 155,949 |
| Customers' deposits and unrestricted investment accounts | 1.84% | 206,036 | 1,185,145 | 277,510 | 4,000 | 779,691 | 2,452,382 |
| Euro medium term notes | 4.30% | - | - | 307,148 | - | - | 307,148 |
| Other liabilities | N/A | 1,109 | - | - | - | 92,425 | 93,534 |
| Taxation | N/A | - | - | - | - | 10,419 | 10,419 |
| Subordinated debt | 4.94% | - | 17,000 | - | - | - | 17,000 |
| Shareholders' equity | N/A | - | - | - | - | 420,990 | 420,990 |
| Tier 1 Perpetual Bonds | 7.88% | - | - | 115,500 | - | - | 115,500 |
| **Total liabilities and shareholders' equity** | | **353,681** | **1,205,995** | **700,158** | **4,000** | **1,309,088** | **3,572,922** |
| **Total interest rate sensitivity gap** | | **637,379** | **(552,850)** | **16,550** | **715,314** | **(816,393)** | **-** |
| **Cumulative interest rate sensitivity gap** | | **637,379** | **84,529** | **101,079** | **816,393** | **-** | **-** |

Basel II and III – Pillar III Report 2018

## Liquidity Risk

Qualitative Disclosures:

Liquidity may be defined as a Bank's ability to ensure the availability of funds to meet all on-balance sheet and off-balance sheet commitments at a reasonable price. Liquidity Risk occurs when the Bank is unable to meet short term obligation when falling due which may raise a potential risk to earnings and capital of the Bank. Conversely, liquidity risk also manifests itself in the form of opportunity losses due to holding excess liquidity relative to liabilities.

The strategy of the Bank in management of liquidity risk is to minimize the resultant impact on the earnings of the Bank. The Bank'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 impacting Bank's reputation. The Bank manages the liquidity risk based on Central Bank of Oman guidelines , Liquidity Risk Policy and Liquidity Contingency Plan.

NBO takes a two-tiered approach to Liquidity Risk Management:

Going concern Liquidity Management - management of the liquidity position within specified parameters to ensure all liabilities can be met on a timely basis.

Event Risk Liquidity Management - ensuring that in the event of either a firm-specific or general market event, the Bank is able to generate sufficient liquidity to withstand a short term liquidity crisis. Event Risk Liquidity Management includes the following tools:

- Stress test: a quantitative analysis of liquidity impact of several (market and bank specific) liquidity crises.
- Liquidity buffer: mitigation of an event risk is achieved through the provision of standby liquidity in the form of unencumbered, Central Bank eligible collateral and stand-by lines.
- Contingency Funding Plan: A comprehensive Liquidity Contingency Plan that documents the procedures that the Bank would adopt to withstand either temporary or prolonged disruptions in its ability to fund some or all of its activities in a timely manner and at a reasonable cost.

The overall Liquidity Risk is kept at such a level that NBO is able to resume its business after a specified crisis.

Treasury division of the Bank receives information from other business units regarding the liquidity profile of their financial assets and liabilities and details of other projected cash flows arising from projected future business. Treasury division maintains a portfolio of short-term liquid assets, largely made up of short-term liquid investment securities and inter-bank facilities, to ensure that sufficient liquidity is maintained within the Bank as a whole.

The Bank is subject to liquidity limits prescribed by the CBO. Additionally, the Bank has also set internal mismatch limits by currency and limits for ensuring that liquidity lines are sufficient to meet short term maturing obligations.

The liquidity position is monitored through the Statement of Maturities of Assets and Liabilities to ensure that the gaps are within the regulatory and internal limits. The Bank also periodically conducts stress tests on liquidity based on market and bank specific scenarios .

Management periodically reviews the strategy and policies related to management of liquidity to ensure that necessary actions are implemented for monitoring and controlling liquidity risk.

The Bank has in place an effective and efficient liquidity risk management structure comprising an active ALCO which meets at monthly intervals and more frequently, if required. ALCO is kept informed regularly of the liquidity position of the Bank and immediately if there are any material changes in the Bank's current or prospective liquidity position.

**The Scope and Nature of the Risk Reporting and/or measurement system:**

Scope and Nature of Risk Reporting:

Maturities of Assets and Liabilities is prepared on a monthly basis and more frequently, as required, setting out the maturity profile of the various assets and liabilities and off-balance sheet items. The statement contains the cumulative gaps vis-à-vis cumulative liabilities for each prescribed time band and the position of these gaps vis-à-vis the Regulatory and in-house limits is also reported therein. This statement is placed before the ALCO at its meetings and in case any of the gap limits is exceeded, the same is escalated immediately to the ALCO along with analysis and further action planned to bring the position within the limits.

A Liquidity Lines statement is also prepared based on assumptions set out in the Liquidity Policy to evaluate the Bank's ability to meet its liabilities maturing in one month time band. Further, the liquidity of the Bank is assessed under bank specific and market specific stress scenarios and impact on gap positions and Liquidity Lines is estimated. Daily Financial Risk Report is used for monitoring the daily ratios and gaps and Early Warning Indicators for assessing any potential liquidity impact of leading indicators. These reports are regularly reviewed by the ALCO, Management and Board Risk Committee.

## Liquidity Risk (continued)

### Measurement:

The monitoring and control of Liquidity Risk is done on an ongoing basis. The Bank uses the maturity ladder approach, which calculates the cumulative surplus or deficit of funds at selected time bands. The cash flows are placed in different time bands based on future behavior of assets, liabilities and off-balance sheet positions. In order to ensure uniformity in the treatment of behavioral patterns of assets, liabilities and off-balance sheet positions, the Central Bank has evolved a broad framework, which has been subscribed to by the Bank. In addition, the Bank regularly evaluates its liquidity position with respect to the liquidity ratios prescribed in the Liquidity Risk Policy.

The Bank has put in place "Liquidity Risk Policy" and "Liquidity Contingency Plan"- duly approved by the Board Risk Committee, which provides detailed guidelines for mitigating the risk. In case of a contingency, the policy provides a blue-print for asset sales, market access and restructuring the maturity and composition of assets and liabilities.

As an on-going mitigant the Bank has in place the availability of liquidity support in the form of committed lines of credit and reciprocal arrangements. The continuing availability of the CBO liquidity window, which was introduced in the wake of the global financial crisis, is also one of the mitigants of the liquidity risk. Besides, the Bank ensures the liquidity of certain assets as per the Liquidity Contingency Plan as a buffer against liquidity events.

The Bank has also put in place Country and Transfer Risk Policies to primarily control and monitor cross border exposures.

## Basel III Liquidity Framework

The Central Bank of Oman has issued guidelines on the implementation of Basel III liquidity framework which are Liquidity Coverage Ratio (LCR) and Net Stable Funding (NSFR).

## Liquidty Coverage Ratio (LCR)

The Liquidity coverage ratio ( LCR) is a short time ratio designed to increase resilience against a liquidity shortage of up to 30 days. The LCR is computed as per CBO requirement under the circular BM1127 (BASEL III : Framework on Liquidity coverage ratio and LCR disclosure standards). It is applicable from January 1, 2015 with a minimum ratio of 60% and increasing by 10% every year thereafter till it reaches a minimum required level of 100% on January 1, 2019, as per the time-line given below:

| | 1 Jan 2015 | 1 Jan 2016 | 1 Jan 2017 | 1 Jan 2018 | 1 Jan 2019 |
|---|---|---|---|---|---|
| Minimum LCR | 60% | 70% | 80% | 90% | 100% |

Liquid Coverage Ratio as per Basel III based on weighted average value is 262.2%

Basel II and III – Pillar III Report 2018

## Net Stable Funding Ratio (NSFR)

The standard of Net Stabe Funding Ratio (NSFR) is a longer term structural ratio designed to address liquidity mismatches and reduce funding risk over a one year horizon. It is effective Janauray 2018, with a minimum ratio of 100% as per the regulatory guidance.

| Item | Unweight value | Weighted value |
|---|---|---|
| **Available Stable Funding** | | |
| Regulatory capital | 540,709 | 540,709 |
| Liabilities with effective residual maturities of one year or more | 498,116 | 498,116 |
| Retail and small business customers | | |
| - Stable Deposits | 654,007 | 621,307 |
| - Less Stable Deposits | 155,057 | 139,551 |
| Wholesale Funding | | |
| - Operational and short term funding | 1,377,288 | 688,644 |
| - Other wholesale funding | 755,036 | 271,577 |
| **Total Available Stable Funding** | | **2,759,904** |
| **Required Stable Funding** | | |
| High quality liquid assets | | |
| - Coins, banknotes and reserves with CBO | 312,862 | - |
| - Other Level 1 assets | 185,292 | 9,265 |
| Funding to financial institutions with residual maturities of less than six months not included in the above categories | 84,007 | 12,601 |
| Funding not included in the above categories with residual maturity of less than one year, including loans to non-financial corporate clients, loans to retail and small business customers, and loans to sovereigns and PSEs | 560,000 | 279,062 |
| Unencumbered residential mortgages that would qualify for the 35% or lower risk weight under Basel II standardised approach for credit risk | 327,674 | 212,988 |
| All other assets not included in the above categories, including non-performing loans, loans to financial institutions with a residual maturity of one year or more, non-exchange-traded equities, fixed assets, items deducted from regulatory capital, retained interest, insurance assets, subsidiary interests and defaulted securities. | 2,074,813 | 2,074,813 |
| **Off Balance Sheet Exposures** | | |
| Irrevocable and conditionally revocable credit and liquidity facilities to any client | 89,656 | 4,483 |
| Other contingent funding obligations, including products and instruments such as guarantees, letters of credit, Unconditionally revocable credit and liquidity facilities | 497,640 | 24,882 |
| **Total Required Stable Funding** | | **2,618,093** |
| **NSFR (Min Basel III requirement - 100%)** | | **105.4%** |

## Leverage Ratio

The leverage ratio deals with the risk of buildup of excessive on and off balance sheet exposures. Minimum Leverage Ratio standard will be made applicable to all the Banks effective from 31 December 2018.

## Basel III leverage ratio framework and disclosure requirements

| **Table 1: Summary comparison of accounting assets vs leverage ratio exposure measure** | | **RO'000** |
|---|---|---|
| **(Please refer to paragraph 52 of Basel III leverage ratio framework and disclosure requirements of BCBS issued in January 2014)** | | |
| | **Item** | **31-Dec-2018** |
| 1 | Total consolidated assets as per published financial statements | 3,572,922 |
| 2 | Adjustment for investments in banking, financial, insurance or commercial entities that are consolidated for accounting purposes but outside the scope of regulatory consolidation | - |
| 3 | Adjustment for fiduciary assets recognised on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure | - |
| 4 | Adjustments for derivative financial instruments | 3,002 |
| 5 | Adjustment for securities financing transactions (i.e., repos and similar secured lending) | - |
| 6 | Adjustment for off-balance sheet items (i.e., conversion to credit equivalent amounts of off-balance sheet exposures) | 241,268 |
| 7 | Other adjustments | - |
| **8** | **Leverage ratio exposure** | **3,817,192** |

| **Table 2: Leverage ratio common disclosure template** | | |
|---|---|---|
| **(Please refer to paragraph 53 of Basel III leverage ratio framework and disclosure requirements of BCBS issued in January 2014)** | | |
| | **Item** | |
| 1 | On-balance sheet items (excluding derivatives and SFTs, but including collateral) | 3,572,922 |
| 2 | (Asset amounts deducted in determining Basel III Tier 1 capital) | - |
| 3 | **Total on-balance sheet exposures** (excluding derivatives and SFTs) (sum of lines 1 and 2) | 3,572,922 |
| | **Derivative Exposures** | - |
| 4 | Replacement cost associated with all derivatives transactions (i.e., net of eligible cash variation margin) | 3,002 |
| 5 | Add-on amounts for PFE associated with all derivatives transactions | - |
| 6 | Gross-up for derivatives collateral provided where deducted from the balance sheet assets pursuant to the operative accounting framework | - |
| 7 | (Deductions of receivables assets for cash variation margin provided in derivatives transactions) | - |
| 8 | (Exempted CCP leg of client-cleared trade exposures) | - |
| 9 | Adjusted effective notional amount of written credit derivatives | - |
| 10 | (Adjusted effective notional offsets and add-on deductions for written credit derivatives) | - |
| **11** | **Total derivative exposures (sum of lines 4 to 10)** | **3,002** |
| | **Securities financing transaction exposures** | |
| 12 | Gross SFT assets (with no recognition of netting), after adjusting for sale accounting transactions | - |
| 13 | (Netted amounts of cash payables and cash receivables of gross SFT assets) | - |
| 14 | CCR exposure for SFT assets | - |
| 15 | Agent transaction exposures | - |
| **16** | **Total securities financing transaction exposures (sum of lines 12 to 15)** | - |
| | **Other Off-balance sheet exposures** | - |
| 17 | Off-balance sheet exposure at gross notional amount | 497,640 |
| 18 | (Adjustments for conversion to credit equivalent amounts) | (256,372) |
| **19** | **Off-balance sheet items (sum of lines 17 and 18)** | **241,268** |
| | **Capital and total exposures** | - |
| **20** | **Tier 1 capital** | 505,356 |
| **21** | **Total exposures (sum of lines 3, 11, 16 and 19)** | **3,817,192** |
| | **Leverage Ratio** | |
| **22** | **Basel III leverage ratio (%)** | **13.2** |

Basel II and III – Pillar III Report 2018

Quantitative Disclosures:

The maturity profile of the assets and liabilities in line with guidelines issued by Central bank of Oman, at 31 December 2018 was as follows:

| | On demand within 3 months RO'000 | 3 to 12 months RO'000 | Subtotal less than 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Subtotal over 12 months RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | 250,988 | 29,343 | 280,331 | 17,879 | 16,845 | 34,724 | 315,055 |
| Due from banks and other money market placements (net) | 78,237 | 10,202 | 88,439 | - | 9,625 | 9,625 | 98,064 |
| Loans, advances and financing activities for customers (net) | 439,718 | 234,739 | 674,457 | 639,487 | 1,495,763 | 2,135,250 | 2,809,707 |
| Financial investments | 112,470 | 2,030 | 114,500 | 33,569 | 83,080 | 116,649 | 231,149 |
| Premises and equipment | - | - | - | - | 64,360 | 64,360 | 64,360 |
| Other assets | 47,308 | 6,909 | 54,217 | 370 | - | 370 | 54,587 |
| **Total assets** | 928,721 | 283,223 | 1,211,944 | 691,305 | 1,669,673 | 2,360,978 | 3,572,922 |
| Due to banks and other money market deposits | 132,849 | 15,400 | 148,249 | 7,700 | - | 7,700 | 155,949 |
| Customers' deposits and unrestricted investment accounts | 596,509 | 839,117 | 1,435,626 | 546,048 | 470,708 | 1,016,756 | 2,452,382 |
| Euro medium term notes | - | 114,648 | 114,648 | 192,500 | - | 192,500 | 307,148 |
| Other liabilities | 85,841 | 5,069 | 90,910 | 2,622 | 2 | 2,624 | 93,534 |
| Taxation | 10,419 | - | 10,419 | - | - | - | 10,419 |
| Subordinated debt | 17,000 | - | 17,000 | - | - | - | 17,000 |
| Shareholders' equity | - | - | - | - | 420,990 | 420,990 | 420,990 |
| Tier 1 perpetual bonds | - | - | - | - | 115,500 | 115,500 | 115,500 |
| **Total liabilities and shareholders' equity** | 842,618 | 974,234 | 1,816,852 | 748,870 | 1,007,200 | 1,756,070 | 3,572,922 |

## Operational Risk

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

The bank follows basic indicator approach for determining operational risk.

The Capital charge for operational risk under Basic Indicator approach is calculated by taking the average of gross income multiplied by 15%, for each of the last three financial years, excluding years of negative or zero gross income. The gross income is Net interest income (+) Non interest income (+) Provisions for unpaid interest (-) realized profit on sale of Available for Sale (AFS) investments (-) extraordinary / irregular items of income.

Capital requirement for operational risk as per Basel II is RO (000s) 31,967

Insurance is another tool used by the bank as an operational risk mitigant. Insurance coverage such as Bankers' Blanket Bond (BBB), Professional Indemnity, incomplete transactions, Directors and Officers liability and cyber liability insurance etc as obtained by the bank, aim at protecting the bank from high severity risks by reducing the financial impact of the same.

In addition to the above and in order to keep control of operational incidences / losses the bank has set in place a special operational risk appetite against which incidents / losses are being monitored regularly for possible breaches and appropriate mitigants are put in place.

## BASEL III – Transition Disclosure:

Further to the Guidelines on composition of capital disclosure requirements (CP1 & CP2) issued by Central Bank of Oman, the following are the mandatory disclosures for the year ended 31 December 2018.

**Prepared under the Guidelines on composition of capital disclosure requirements**

**Table 2a** **RO'000s**

| | Balance sheet as in published financial statements |
|---|---|
| | **31-Dec-18** |
| **Assets** | |
| Cash and balances with Central Bank of Oman | 315,055 |
| Certificates of deposit | - |
| Due from banks | 85,353 |
| Loans and advances to banks | 12,711 |
| Loans and advances | 2,809,707 |
| Investments in securities | 231,149 |
| Property and equipment | 64,360 |
| Deferred tax assets | 734 |
| Other assets | 53,853 |
| **Total assets** | **3,572,922** |
| **Liabilities** | |
| Due to banks | 155,949 |
| Customer deposits | 2,452,382 |
| Euro medium term notes | 307,148 |
| Other liabilities | 103,953 |
| Subordinated bonds | 17,000 |
| **Total liabilities** | **3,036,432** |
| **Shareholders' Equity** | |
| Paid-up share capital | 162,595 |
| Share premium | 34,465 |
| Legal reserve | 54,198 |
| General reserve | - |
| Retained earnings | 153,191 |
| Other reserves | 16,541 |
| Cumulative changes in fair value of investments | - |
| Subordinated debt reserve | - |
| Tier 1 perpetual bond | 115,500 |
| **Total shareholders' equity** | **536,490** |
| **Total liability and shareholders' funds** | **3,572,922** |

Basel II and III – Pillar III Report 2018

## BASEL III – Transition Disclosure (continued)

**Prepared under the Guidelines on composition of capital disclosure requirements**

**Table 2b** **RO'000s**

| | Balance sheet as in published financial statements | Reference |
|---|---|---|
| | **31-Dec-18** | |
| **Assets** | | |
| Cash and balances with Central Bank of Oman | 315,055 | |
| Certificates of deposit | - | |
| Balance with banks and money at call and short notice | 85,353 | |
| Investments in securities | 231,149 | |
| **Loans and advances of which :** | | |
| Loans to Banks - Gross | 13,090 | |
| General Provisions considered for Tier 2 | (379) | A1 |
| Net Loans to banks | 12,711 | |
| Loans to Customers - Gross | 2,923,361 | |
| Specific Provisions | (76,493) | A1 |
| General Provisions considered for Tier 2 | (37,161) | |
| Net Loans to customers | 2,809,707 | |
| Fixed assets | 64,360 | |
| Other assets of which: | 53,853 | |
| Deferred tax assets | 734 | A2 |
| Amount considered for CET1 | (734) | |
| Current year allocation - not eligible | - | |
| **Total Assets** | **3,572,922** | |
| **Capital & Liabilities** | | |
| Paid-up Capital | 197,060 | |
| Of which: | | C1 |
| Amount eligible for CET1 | 197,060 | |
| Amount eligible for AT1 | - | |
| Reverses and Surplus | 153,191 | |
| Of which: Amount eligible for CET1 | | |
| Retained earnings carried forward | 153,191 | |
| Profit for current year not eligible | - | |
| Legal reserve | 54,198 | C2 |
| General reserve | - | |
| Subordinated debt reserve | 17,000 | |
| Proposed Stock Dividend | - | |
| **Total Amount eligible for CET1** | **71,198** | C3 |
| Tier 1 perpetual bond | 115,500 | C7 |
| Proposed Cash Dividend | 26,015 | |
| Cumulative changes in fair value of investments | 4,844 | |
| Amount eligible for Tier 1 | (4,844) | A2 |
| Revaluation reserve | 16,541 | |
| **Total Capital** | **553,490** | |

## BASEL III – Transition Disclosure (continued)

| | Balance sheet as in published financial statements | Reference |
|---|---|---|
| | **31-Dec-18** | |
| Deposits of which: | | |
| Deposits from banks | 155,949 | |
| Customer deposits | 2,338,150 | |
| Deposits of Islamic Banking window | 114,232 | |
| Euro medium term notes | 307,148 | |
| Other deposits (Sub-debt) | - | |
| Other liabilities & provisions of which: | 103,953 | |
| **Total** | **3,572,922** | |

**Prepared under the Guidelines on composition of capital disclosure requirements**

**Table 4**

| Basel III common disclosure template to be used during the transition of regulatory adjustments (RO '000) | Component of regulatory capital reported by bank | Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2 |
|---|---|---|
| **Common Equity Tier 1 capital: instruments and reserves** | | |
| Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus | 197,060 | C1 |
| Retained earnings | 127,176 | C2 |
| Accumulated other comprehensive income (and other reserves) | 71,198 | C3 |
| Public sector capital injections grandfathered until 1 January 2018 | - | |
| Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | - | |
| **Common Equity Tier 1 capital before regulatory adjustments** | **395,434** | |
| **Common Equity Tier 1 capital: regulatory adjustments** | | A2 |
| Deferred tax assets arising from temporary differences (net of related tax liability) | (734) | |
| Cumulative fair value gains or losses on available for sale instruments | (5,730) | A2 |
| **Total regulatory adjustments to Common equity Tier 1** | **(6,464)** | |
| Common Equity Tier 1 capital (CET1) | 388,970 | |
| Additional Tier 1 capital: instruments (TIER1 PERPETUAL BOND) | 115,500 | C7 |
| Additional Tier 1 capital: regulatory adjustments - Nil | | |
| **Tier 1 capital (T1 = CET1 + AT1)** | **504,470** | |

Basel II and III – Pillar III Report 2018

## BASEL III – Transition Disclosure (continued)

| | Component of regulatory capital reported by bank | Source based on reference numbers / letters of the balance sheet under the regulatory scope of consolidation from step 2 |
|---|---|---|
| **Tier 2 capital: instruments and provisions** | | |
| Directly issued qualifying Tier 2 instruments plus related stock surplus | - | C6-C4 |
| Directly issued capital instruments subject to phase out from Tier 2 | - | |
| Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) | - | |
| Of which: instruments issued by subsidiaries subject to phase out | - | |
| General provisions | 35,830 | A1 |
| Cumulative fair value gains or losses on available for sale instruments | 409 | C5 |
| **Tier 2 capital before regulatory adjustments** | **36,239** | |
| **Tier 2 capital: regulatory adjustments** | | |
| National specific regulatory adjustments | - | |
| Regulatory adjustments applied to Tier 2 in respect of amounts subject to Pre-Basel III treatment. | - | |
| Of which: Cumulative fair value gains or losses on available for sale instruments | - | |
| **Total regulatory adjustments to Tier 2 capital** | - | |
| **Tier 2 capital (T2)** | **36,239** | |
| **Total capital (TC = T1 + T2)** | **540,709** | |

## Basel III common disclosure

| | Amounts |
|---|---|
| **Common Equity Tier 1 capital: instruments and reserves** | |
| Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus | 197,060 |
| Retained earnings | 127,176 |
| Accumulated other comprehensive income (and other reserves) | 71,198 |
| Public sector capital injections grandfathered until 1 January 2018 | - |
| Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | - |
| **Common Equity Tier 1 capital before regulatory adjustments** | **395,434** |
| **Common Equity Tier 1 capital: regulatory adjustments** | |
| Deferred tax assets arising from temporary differences (net of related tax liability) | (734) |
| Gains and losses due to changes in own credit risk on fair valued liabilities. | (5,730) |
| **Total regulatory adjustments to Common equity Tier 1** | **(6,464)** |
| **Common Equity Tier 1 capital** | **388,970** |
| **Additional Tier 1 capital: instruments** | **115,500** |
| **Additional Tier 1 capital: regulatory adjustments Nil** | |
| **Tier 1 capital** | **504,470** |

## Basel III Common Disclosure (continued)

| | Amounts |
|---|---|
| **Tier 2 capital: instruments and provisions** | |
| Directly issued qualifying Tier 2 instruments plus related stock surplus | - |
| Directly issued capital instruments subject to phase out from Tier 2 | - |
| Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) | - |
| Of which: instruments issued by subsidiaries subject to phase out | - |
| Provisions | 36,239 |
| **Tier 2 capital before regulatory adjustments** | **36,239** |
| **Tier 2 capital: regulatory adjustments** | |
| National specific regulatory adjustments | - |
| Regulatory adjustments applied to Tier 2 in respect of amounts subject to Pre-Basel III treatment. | - |
| Of which: Cumulative fair value gains or losses on available for sale instruments | - |
| **Total regulatory adjustments to Tier 2 capital** | **-** |
| **Tier 2 capital** | **36,239** |
| **Total capital** | **540,709** |
| **Total risk weighted assets** | **3,324,192** |
| Of which: Credit risk weighted assets | 3,010,792 |
| Of which: Market risk weighted assets | 65,115 |
| Of which: Operational risk weighted assets | 248,285 |
| **Capital Ratios** | |
| **Common Equity Tier 1 (as a percentage of risk weighted assets)** | **11.7** |
| **Tier 1 (as a percentage of risk weighted assets)** | **15.2** |
| **Total capital (as a percentage of risk weighted assets)** | **16.3** |
| Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB/D-SIB buffer requirement expressed as a percentage of risk weighted assets) | - |
| of which: capital conservation buffer requirement | - |
| of which: bank specific countercyclical buffer requirement | - |
| of which: D-SIB/G-SIB buffer requirement | - |
| Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets | 3.520 |
| **National minima (if different from Basel III)** | |
| **National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum)** | **8.875** |
| **National Tier 1 minimum ratio (if different from Basel 3 minimum)** | **10.875** |
| **National total capital minimum ratio (if different from Basel 3 minimum)** | **12.875** |

Basel II and III – Pillar III Report 2018

## Disclosure template for main features of all regulatory capital instruments

**1. Common Equity.**

Common equity comprises of 1,625,946,355 equity shares of RO 0.100 each fully paid up, issued and governed under the laws of Sultanate of Oman.

**2. All other regulatory capital instruments**

| | | | | |
|---|---|---|---|---|
| 1 | Issuer | - | National Bank of Oman | National Bank of Oman |
| 2 | Unique identifier (eg CUSIP, ISIN or Bloomberg identifier for private placement) | - | XS1321921899 | Private Placements comprises of 2 issues |
| 3 | Governing law(s) of the instrument | - | English | Sultanate of Oman |
| 4 | Transitional Basel III rules | - | Additional Tier 1 | Tier 2 |
| 5 | Post-transitional Basel III rules | - | Eligible | Ineligible |
| 6 | Eligible at solo/group/group & solo | - | Solo | Solo |
| 7 | Instrument type | - | Additional Tier 1 | Subordinated debts |
| 8 | Amount recognised in regulatory capital | - | RO 115.5 million | RO NIL million (Aggregate of 2 issues) |
| 9 | Par value of instrument | - | RO 115.5 million | RO 17.0 million (Aggregate of 2 issues) |
| 10 | Accounting classification | - | Equity | Liability –amortised cost |
| 11 | Original date of issuance | - | 18-Nov-15 | Between Dec 2013 to Mar 2013 |
| 12 | Perpetual or dated | - | Perpetual | Dated |
| 13 | Original maturity date | - | Not applicable | Dec 2018 to Mar 2019 |
| 14 | Issuer call subject to prior supervisory approval | - | Yes | Yes – 0 issue, No –2 issues |
| 15 | Optional call date, contingent call dates and redemption amount | - | 18-Nov-20 | Not applicable |
| 16 | Subsequent call dates, if applicable | - | Every five years | Not applicable |
| **Coupons / dividends** | | | | |
| 17 | Fixed or floating dividend/coupon | - | Fixed | Fixed |
| 18 | Coupon rate and any related index | - | 7.875% | 4.50% to 5.25% |
| 19 | Existence of a dividend stopper | - | Yes | No |
| 20 | Fully discretionary, partially discretionary or mandatory | - | Fully discretionary | Mandatory |
| 21 | Existence of step up or other incentive to redeem | - | No | No |
| 22 | Noncumulative or cumulative | - | Non cumulative | Not applicable |
| 23 | Convertible or non-convertible | - | Non convertible | Non-convertible |
| 24 | If convertible, conversion trigger (s) | - | Not applicable | Not applicable |
| 25 | If convertible, fully or partially | - | Not applicable | Not applicable |
| 26 | If convertible, conversion rate | - | Not applicable | Not applicable |
| 27 | If convertible, mandatory or optional conversion | - | Not applicable | Not applicable |
| 28 | If convertible, specify instrument type convertible into | - | Not applicable | Not applicable |
| 29 | If convertible, specify issuer of instrument it converts into | - | Not applicable | Not applicable |
| 30 | Write-down feature | - | Yes | No |
| 31 | If write-down, write-down trigger(s) | - | Non viability event | No |
| 32 | If write-down, full or partial | - | Full (See note) | No |
| 33 | If write-down, permanent or temporary | - | Permanent | No |
| 34 | If temporary write-down, description of write-up mechanism | - | Not applicable | No |
| 35 | Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument) | - | Subordinated to Senior Liabilities and Tier 2 - Subordinted debts | Subordinated to Senior Liabilities |
| 36 | Non-compliant transitioned features | - | No | No |
| 37 | If yes, specify non-compliant features | - | Not applicable | Not applicable |

Note: The Capital Securities can be cancelled (in the case of a write-down in whole) or written-down in part on a pro rata basis (in the case of a write-down in part) as determined by the Bank in conjunction with the Regulator in accordance with the Capital Regulations.

This report on Basel II & III disclosures was authorized for issue by the Board of Directors on 29 January 2019.

**Rawan bint Ahmed Al Said**
Chairperson

# Statement of Financial Position as at 31 December 2018

Ernst & Young LLC
P.O. Box 1750, Ruwi 112
5th Floor, Landmark Building
Opposite Al Ameen Mosque
Bowsher, Muscat
Sultanate of Oman

Tel: +968 22 504 559
Fax: +968 22 060 810
muscat@om.ey.com
ey.com/mena
C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG

### Report on the audit of the financial statements

*Opinion*

We have audited the financial statements of National Bank of Oman SAOG (the "bank"), which comprise the statement of financial position as at 31 December 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

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

*Basis for opinion*

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

*Key audit matters*

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

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying financial statements.



## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG (CONTINUED)

### Report on the audit of the financial statements (continued)

*Key audit matters (continued)*

1. Impairment provision on loans, advances and financing activities for customers subject to credit risk

| *Key audit matters* | *How our audit addressed the key audit matters* |
|---|---|
| In accordance with the requirements of Central Bank of Oman's circular BM 1149 dated 13 April 2017, effective from 1 January 2018, the Bank has adopted IFRS 9 which introduced new impairment based on expected credit losses, rather than the incurred loss model previously applied.<br><br>At 31 December 2018 the Bank reported gross loans, advances and financing activities for customers amounting to RO 2,940.09 million and RO 130.38 million of expected credit loss allowances.<br><br>Due to the inherently judgmental nature of the computation of expected credit losses ("ECL") for loans, advances and financing activities for customers, we considered this matter as a key audit matter.<br><br>The key areas of judgement include:<br><br>‣ The identification of exposure with a significant deterioration in credit quality.<br>‣ Assumptions used in the ECL model such as financial condition of counterparty, expected future cash flows, forward looking macroeconomic factors etc.<br>‣ The need to apply additional overlays to reflect current or future external factors that might not be captured by the expected credit loss model.<br><br>The accounting policies relating to estimating impairment provision on loans, advances and financing activities for customers, critical accounting estimates and judgements, and the disclosures relating to impairment of loans, advances and financing activities for customers associated with credit risk are set out in notes 3.2, 2.4.2 and 6 to the financial statements. | Our audit procedures in this area included the following:<br><br>• Evaluated the appropriateness of the Bank's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9;<br>• We performed audit procedures on the opening balances. This included evaluating the accounting interpretations for compliance with IFRS 9 and testing the adjustments and disclosures made on transition.<br>• Obtained an understanding of the design and tested the operating effectiveness of relevant controls over ECL model, including model build and approval, ongoing monitoring / validation, model governance and mathematical accuracy. We have also checked completeness and accuracy of the data used and management assumptions;<br>• Evaluated Bank's key judgments and estimates made in the ECL computation and involved specialists to assist in evaluating the judgments and estimates relating to probability of default, macro-economic variables and recovery rates;<br>• For a sample of exposures, we performed procedures to evaluate:<br>- Appropriateness of exposure at default, probability of default and loss given default (including collateral values used) in the calculation of ECL;<br>- Timely identification of exposures with a significant increase in credit risk and appropriateness of the Bank's staging; and<br>- ECL calculation.<br>• Checked the completeness of the loans, advances and financing activities for customers (including off balance sheets) in the ECL calculation as of 31 December 2018. We understood the theoretical soundness and tested the mathematical integrity of the models;<br>• Checked the consistency of various inputs and assumptions used by the Bank's management to determine impairment provisions; and<br>• Considered the adequacy of the disclosures in the financial statements in relation to impairment of loans, advances and financing activities for customers and other financial assets subject to credit risk as required under IFRS 9. |

EY
Building a better working world

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG (CONTINUED)

### Report on the audit of the financial statements (continued)

*Other information included in the bank's 2018 Annual Report*
Those charged with governance and management are responsible for the other information. Other information consists of the information included in the bank's 2018 Annual Report other than the financial statements and our auditor's report thereon. We obtained the following information prior to the date of our auditor's report, and we expect to obtain the published 2018 Annual Report after the date of our auditor's report:

- Chairman's report
- Corporate governance report
- Management discussion and analysis
- Financial statements of the Islamic Banking Window
- Basel II Pillar III and Basel III Report of the bank
- Basel II Pillar III and Basel III Report of the Islamic Banking Services.

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

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

*Responsibilities of management and those charged with governance for the financial statements*
Those charged with governance are responsible for the preparation and fair presentation of the financial statements in accordance with IFRS and the relevant requirements of the Commercial Companies Law of 1974, as amended, and the Capital Market Authority ("the CMA") of the Sultanate of Oman, and for such internal control as those charged with governance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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

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

EY
Building a better working world

## INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG (CONTINUED)

### Report on the audit of the financial statements (continued)

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

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

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

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

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

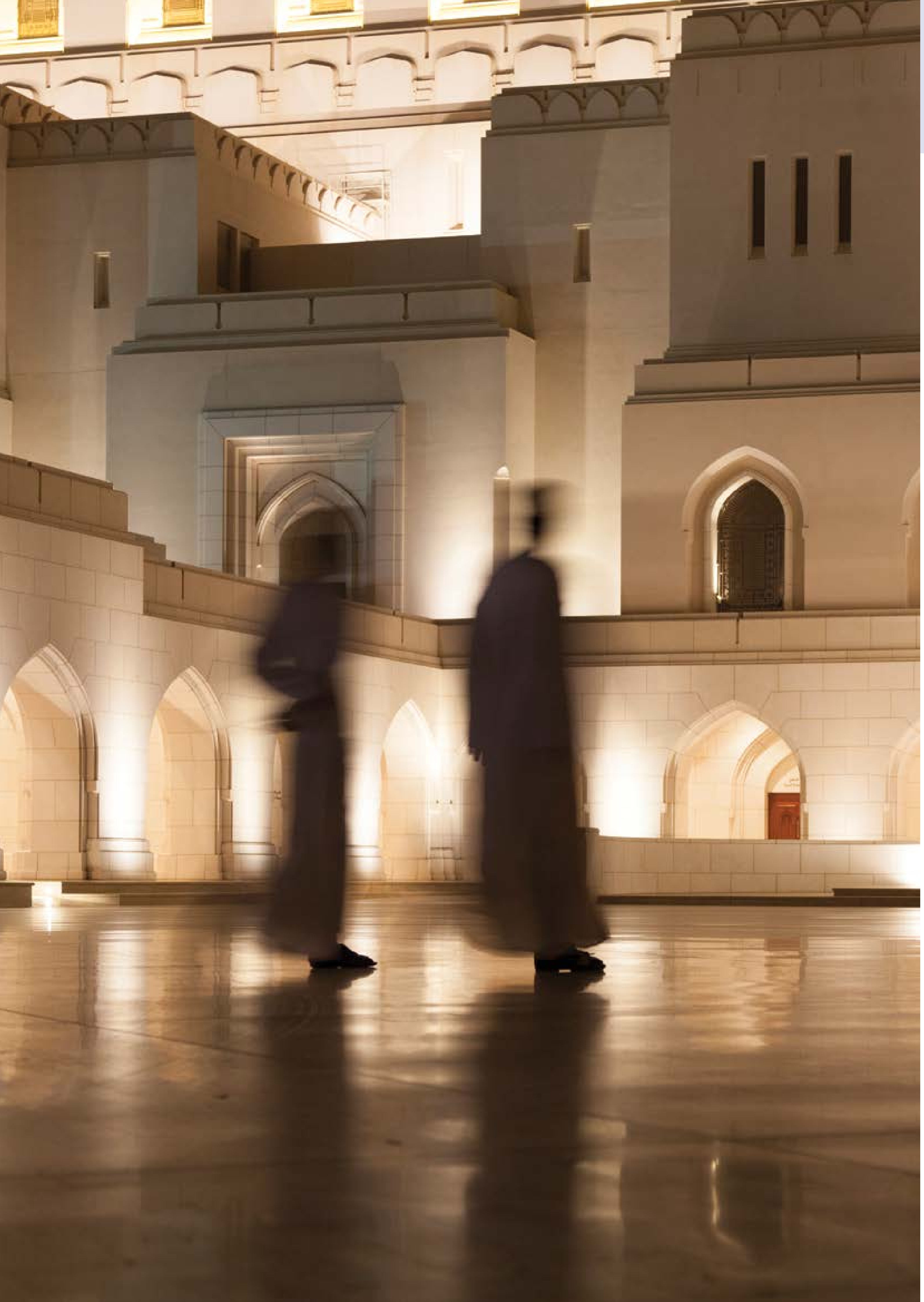
From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation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

**Report on other legal and regulatory requirements**
In our opinion, the financial statements comply, in all material respects, with the relevant requirements of the Commercial Companies Law of 1974, as amended, and CMA of the Sultanate of Oman.

Ernst & Young LLC

ارنست ويونغ ش م م
س.ت: ١٢٢٤٠١٣
ص.ب: ١٧٥٠ روي - ١١٢، سلطنة عمان
EY ERNST & YOUNG LLC
C.R. No. 1224013
P.O. Box 1750 - P.C. 112, Sultanate of Oman

Philip Stanton
Muscat
10 March 2019



# Statement of Financial Position
## as at 31 December 2018

| 2017 USD'000 | 2018 USD'000 | | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|---|
| | | **Assets** | | | |
| 995,094 | **818,325** | Cash and balances with Central Banks | 4 | **315,055** | 383,111 |
| 360,182 | **254,712** | Due from banks and other money market placements (net) | 5 | **98,064** | 138,670 |
| 6,893,171 | **7,297,940** | Loans, advances and financing activities for customers (net) | 6 | **2,809,707** | 2,653,871 |
| 475,636 | **600,387** | Financial investments | 7 | **231,149** | 183,120 |
| 170,896 | **167,169** | Premises and equipment | 8 | **64,360** | 65,795 |
| 118,922 | **141,783** | Other assets | 9 | **54,587** | 45,785 |
| 9,013,901 | **9,280,316** | **Total Assets** | | **3,572,922** | 3,470,352 |
| | | **Liabilities and Equity** | | | |
| | | **Liabilities** | | | |
| 326,642 | **405,062** | Due to banks and other money market deposits | 10 | **155,949** | 125,757 |
| 6,392,901 | **6,369,823** | Customers' deposits and unrestricted investment accounts | 11 | **2,452,382** | 2,461,267 |
| 599,756 | **797,787** | Euro medium term notes | 12 | **307,148** | 230,906 |
| 190,512 | **242,945** | Other liabilities | 13 | **93,534** | 73,347 |
| 20,301 | **27,062** | Taxation | 14 | **10,419** | 7,816 |
| 64,935 | **44,156** | Subordinated debt | 15 | **17,000** | 25,000 |
| 7,595,047 | **7,886,835** | **Total Liabilities** | | **3,036,432** | 2,924,093 |
| | | **Equity** | | | |
| 402,213 | **422,325** | Share capital | 16 | **162,595** | 154,852 |
| 89,519 | **89,519** | Share premium | 17 | **34,465** | 34,465 |
| 134,070 | **140,774** | Legal reserve | 18 | **54,198** | 51,617 |
| 61,010 | **42,964** | Other non-distributable reserves | 19 | **16,541** | 23,489 |
| 60,332 | **67,571** | Proposed cash dividend | 21 | **26,015** | 23,228 |
| 20,112 | **-** | Proposed stock dividend | 21 | **-** | 7,743 |
| 351,598 | **330,328** | Retained earnings | | **127,176** | 135,365 |
| **1,118,854** | **1,093,481** | **Total shareholders' equity attributable to the equity holders of the bank** | | **420,990** | **430,759** |
| 300,000 | **300,000** | Tier 1 Perpetual Bond | 20 | **115,500** | 115,500 |
| 1,418,854 | **1,393,481** | **Total Equity** | | **536,490** | 546,259 |
| 9,013,901 | **9,280,316** | **Total Liabilities and Equity** | | **3,572,922** | 3,470,352 |

*The financial statements were authorised for issue on 29 January 2019 in accordance with a resolution of the Board of Directors.*

Chairperson

Acting Chief Executive Officer

The attached notes 1 to 35 form part of these financial statements.

# Statement of Comprehensive Income
For the year ended 31 December 2018

| 2017 USD'000 | 2018 USD'000 | | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|---|
| 389,288 | **396,506** | Interest income | 23 | **152,655** | 149,876 |
| (143,145) | **(163,810)** | Interest expense | 24 | **(63,067)** | (55,111) |
| 246,143 | **232,696** | **Net interest income** | | **89,588** | 94,765 |
| 15,138 | **16,296** | Income from Islamic financing and investment activities | | **6,274** | 5,828 |
| (7,951) | **(9,047)** | Unrestricted investment account holders' share of profit | | **(3,483)** | (3,061) |
| 7,187 | **7,249** | **Net Income from Islamic financing and investment activities** | | **2,791** | 2,767 |
| 253,330 | **239,945** | **Net interest income and net income from Islamic financing and Investment activities** | | **92,379** | 97,532 |
| 89,862 | **95,158** | Other operating income | 25 | **36,636** | 34,597 |
| 343,193 | **335,103** | **Operating income** | | **129,015** | 132,129 |
| (98,125) | **(99,886)** | Staff costs | | **(38,456)** | (37,778) |
| (58,514) | **(48,906)** | Other operating expenses | 26 | **(18,829)** | (22,528) |
| (10,940) | **(11,577)** | Depreciation | 8 | **(4,457)** | (4,212) |
| (167,579) | **(160,369)** | **Total operating expenses** | | **(61,742)** | (64,518) |
| 175,614 | **174,734** | **Profit from operations before impairment losses and tax** | | **67,273** | 67,611 |
| (65,229) | **(48,021)** | Credit loss expense – customers' loan | 6 | **(18,488)** | (25,113) |
| 7,810 | **11,751** | Recoveries and releases from provision for credit losses | 6 | **4,524** | 3,007 |
| 16,805 | **17,075** | Recoveries from loans and advances written off | | **6,574** | 6,470 |
| - | **(231)** | Credit losses on investments | | **(89)** | - |
| (1,787) | **-** | Impairment losses on available-for-sale investments | | **-** | (688) |
| (68) | **213** | Credit loss write back/(expense) for due from banks | | **82** | (26) |
| (42,469) | **(19,213)** | **Total impairment losses (Net)** | | **(7,397)** | (16,350) |
| 133,145 | **155,521** | **Profit before tax** | | **59,876** | 51,261 |
| (18,792) | **(24,073)** | **Taxation** | 14 | **(9,268)** | (7,235) |
| 114,353 | **131,448** | **Profit for the year** | | **50,608** | 44,026 |

The attached notes 1 to 35 form part of these financial statements.





| 2017 USD'000 | 2018 USD'000 | | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|---|
| | | **Other comprehensive expense** | | | |
| - | **(4,392)** | **Items that will not be reclassified subsequently to profit or loss** Revaluation (losses)/gains on equity instruments at fair value through other comprehensive income | | **(1,691)** | - |
| - | **(1,281)** | Debt instruments at fair value through other comprehensive income | | **(493)** | - |
| (11,473) | **-** | Net movement on AFS investments | 7 | **-** | (4,417) |
| 1,787 | **-** | Impairment losses on available-for sale investments already recognised in comprehensive income | | **-** | 688 |
| 317 | **(244)** | Tax effect of net results on FVOCI/AFS financial investments | | **(94)** | 122 |
| (9,369) | **(5,917)** | **Other comprehensive expense for the year** | | **(2,278)** | (3,607) |
| 104,984 | **125,531** | **Total comprehensive income for the year** | | **48,330** | 40,419 |
| 0.06 | **0.06** | **Earnings per share: (USD) – Basic and diluted – (RO)** | 28 | **0.024** | 0.021 |

The attached notes 1 to 35 form part of these financial statements.

# Statement of Changes in Equity
## For the year ended 31 December 2018

Statement of Changes in Equity
For the year ended 31 December 2018

| | Attributable to equity holders of Bank | | | | Attributable to equity holders of Bank | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital RO'000 | Share premium RO'000 | Legal reserve RO'000 | Other non distributable reserves (note 19) RO'000 | Proposed cash dividend (note 21) RO'000 | Proposed stock dividend (note 21) RO'000 | Retained earnings RO'000 | Total RO'000 | Tier 1 perpetual bond RO'000 | Total RO'000 |
| Balance at 1 January 2018 | **154,852** | **34,465** | **51,617** | **23,489** | **23,228** | **7,743** | **135,365** | **430,759** | **115,500** | **546,259** |
| Impact of adopting IFRS 9 (note 2.5(a)) | **-** | **-** | **-** | **(70)** | **-** | **-** | **(23,684)** | **(23,754)** | **-** | **(23,754)** |
| **Restated opening balance under IFRS 9** | **154,852** | **34,465** | **51,617** | **23,419** | **23,228** | **7,743** | **111,681** | **407,005** | **115,500** | **522,505** |
| Total comprehensive income for the year | **-** | **-** | **-** | **(2,278)** | **-** | **-** | **50,608** | **48,330** | **-** | **48,330** |
| Issue of bonus shares (note 28) | **7,743** | **-** | **-** | **-** | **-** | **(7,743)** | **-** | **-** | **-** | **-** |
| Dividend paid (note 21) | **-** | **-** | **-** | **-** | **(23,228)** | **-** | **-** | **(23,228)** | **-** | **(23,228)** |
| Interest on tier 1 perpetual bond | **-** | **-** | **-** | **-** | **-** | **-** | **(9,096)** | **(9,096)** | **-** | **(9,096)** |
| Withholding tax provision on tier 1 perpetual bond | **-** | **-** | **-** | **-** | **-** | **-** | **(2,021)** | **(2,021)** | **-** | **(2,021)** |
| Transfer to retained earnings | **-** | **-** | **-** | **(8,000)** | **-** | **-** | **8,000** | **-** | **-** | **-** |
| Transfer to subordinated debts reserve (note 19) | **-** | **-** | **-** | **3,400** | **-** | **-** | **(3,400)** | **-** | **-** | **-** |
| Transfer to legal reserve (note 18) | **-** | **-** | **2,581** | **-** | **-** | **-** | **(2,581)** | **-** | **-** | **-** |
| Proposed dividend | **-** | **-** | **-** | **-** | **26,015** | **-** | **(26,015)** | **-** | **-** | **-** |
| **Balance at 31 December 2018** | **162,595** | **34,465** | **54,198** | **16,541** | **26,015** | **-** | **127,176** | **420,990** | **115,500** | **536,490** |
| **Balance at 31 December 2018 – In USD'000** | **422,325** | **89,519** | **140,774** | **42,964** | **67,571** | **-** | **330,328** | **1,093,481** | **300,000** | **1,393,481** |
| Balance at 1 January 2017 | 147,478 | 34,465 | 49,159 | 46,196 | 23,478 | 7,374 | 114,764 | 422,914 | 115,500 | 538,414 |
| Total comprehensive income for the year | - | - | - | (3,607) | - | - | 44,026 | 40,419 | - | 40,419 |
| Issue of bonus shares (note 28) | 7,374 | - | - | - | - | (7,374) | - | - | - | - |
| Dividend paid (note 21) | - | - | - | - | (23,478) | - | - | (23,478) | - | (23,478) |
| Interest on tier 1 perpetual bond | - | - | - | - | - | - | (9,096) | (9,096) | - | (9,096) |
| Transfer to retained earnings | - | - | - | (24,100) | - | - | 24,100 | - | - | - |
| Transfer to subordinated debt reserve (note 19) | - | - | - | 5,000 | - | - | (5,000) | - | - | - |
| Transfer to legal reserve (note 18) | - | - | 2,458 | - | - | - | (2,458) | - | - | - |
| Proposed dividend | - | - | - | - | 23,228 | 7,743 | (30,971) | - | - | - |
| Balance at 31 December 2017 | 154,852 | 34,465 | 51,617 | 23,489 | 23,228 | 7,743 | 135,365 | 430,759 | 115,500 | 546,259 |
| Balance at 31 December 2017 – In USD'000 | 402,213 | 89,519 | 134,070 | 61,010 | 60,332 | 20,112 | 351,598 | 1,118,854 | 300,000 | 1,418,854 |

The attached notes 1 to 35 form part of these financial statements.

| 2017 USD'000 | 2018 USD'000 | | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|---|
| | | **Operating Activities** | | | |
| 133,145 | **155,521** | Profit before taxation | | **59,876** | 51,261 |
| 10,940 | **11,577** | Adjustments for: Depreciation | 8 | **4,457** | 4,212 |
| 65,229 | **48,021** | Provision for credit losses – customers' loans | | **18,488** | 25,113 |
| 68 | **(213)** | Provision for credit losses/write back–due from banks | | **(82)** | 26 |
| 1,787 | **231** | Impairment losses on available for sale investments | 7 | **89** | 688 |
| (3) | **-** | Profit on sale of equipment (net) | | **-** | (1) |
| (4,829) | **(306)** | Profit on sale of investments | 25 | **(118)** | (1,859) |
| (3,488) | **(3,268)** | Investment income | | **(1,258)** | (1,343) |
| 202,849 | **211,563** | Operating profit before changes in operating assets and Liabilities | | **81,452** | 78,097 |
| 29,104 | **17,122** | Due from banks and other money market placements | | **6,592** | 11,205 |
| (263,694) | **(50,138)** | Due to banks and other money market deposits | | **(19,303)** | (101,522) |
| (22,605) | **(487,748)** | Loans, advances and financing activities for customers (net) | | **(187,783)** | (8,703) |
| 40,766 | **(25,003)** | Other assets | | **(9,626)** | 15,695 |
| 160,795 | **(23,078)** | Customers' deposits | | **(8,885)** | 61,906 |
| - | **198,031** | Euro medium term notes | | **76,242** | – |
| (23,156) | **27, 605** | Other liabilities | | **10,628** | (8,915) |
| 124,059 | **(131,646)** | **Cash (used in)/from operations** | | **(50,683)** | 47,763 |
| (19,319) | **(15,408)** | Taxes paid | | **(5,932)** | (7,438) |
| 104,740 | **(147,054)** | **Net cash (used in)/from operating activities** | | **(56,615)** | 40,325 |
| | | **Investing Activities** | | | |
| (246,810) | **(151,696)** | Purchase of investments | | **(58,403)** | (95,022) |
| 40,940 | **6,634** | Proceeds from sale of investments | | **2,554** | 15,762 |
| 57,143 | **14,285** | Proceeds from maturity of government development bonds | | **5,500** | 22,000 |
| (61,506) | **(7,906)** | Purchase of premises and equipment | 8 | **(3,044)** | (23,680) |
| 55 | **52** | Disposal of premises and equipment | | **20** | 21 |
| 3,488 | **3,268** | Dividend income | 25 | **1,258** | 1,343 |
| (13) | **-** | Translation differences on premises and equipment and tax | | **-** | (5) |
| (206,703) | **(135,363)** | **Net cash used in investing activities** | | **(52,115)** | (79,581) |
| | | **Financing Activities** | | | |
| (60,982) | **(60,332)** | Payment of dividend | | **(23,228)** | (23,478) |
| (62,597) | **(20,779)** | Net movement in subordinated debt | 15 | **(8,000)** | (24,100) |
| (23,626) | **(28,875)** | Interest on Tier 1 perpetual bond | | **(11,117)** | (9,096) |
| (147,205) | **(109,986)** | **Net cash used in financing activities** | | **(42,345)** | (56,674) |





| 2017 USD'000 | 2018 USD'000 | | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|---|
| (249,168) | **(392,403)** | **Decrease in cash and cash equivalents** | | **(151,075)** | (95,930) |
| 1,305,177 | **1,056,009** | Cash and cash equivalents at the beginning of the year | | **406,563** | 502,493 |
| 1,056,009 | **663,606** | **Cash and cash equivalents at the end of the year** | | **255,488** | 406,563 |
| | | **Representing:** | | | |
| 993,795 | **817,026** | **Cash and balances with Central Banks** | 4 | **314,555** | 382,611 |
| 278,782 | **191,701** | Due from banks maturing within three months | | **73,805** | 107,331 |
| (216,568) | **(345,121)** | Due to banks maturing within three months | | **(132,872)** | (83,379) |
| 1,056,009 | **663,606** | **Total** | | **255,488** | 406,563 |

Notes to the Financial Statements
As at 31 December 2018

## 1 Legal status and principal activities

National Bank of Oman SAOG ("NBO", "the bank") was established in the Sultanate of Oman in 1973 as a joint stock company and is engaged in retail, wholesale, investment and Islamic banking services within the Sultanate of Oman and overseas branches in the United Arab Emirates and Egypt. In Oman the bank operates under banking license issued by the Central Bank of Oman and is covered by its deposit insurance scheme, whereas in the United Arab Emirates and in Egypt the branches operate under a commercial bank licences given by the respective Central Banks. The bank is head quartered in Azaibah, and it is registered address of the bank is PO Box 751, Ruwi, Postal Code 112, Muscat, Sultanate of Oman. The bank has a primary listing on the Muscat Stock Exchange. Its bonds and AT1 capital instruments are listed in the Irish Stock exchange.

The bank employed 1,563 employees as of 31 December 2018 (31 December 2017 – 1,501 employees).

## 2 Basis of preparation

### 2.1 Basis of measurement

The financial statements are prepared under the historical cost basis except for the following:

- derivative financial instruments are measured at fair value;
- financial instruments classified as trading and at fair value through profit or loss (FVTPL)
- are measured at fair value;
- available-for-sale financial assets are measured at fair value (before 1 January 2018);
- financial assets at fair value through other comprehensive income (applicable from 1 January 2018);
- recognised assets and liabilities that are hedged are measured at fair value in respect of the risk that is hedged.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the bank's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 2.4.

### 2.2 Functional and presentation currency

These financial statements are presented in Rial Omani rounded to the nearest thousand Rial Omani, except when otherwise indicated. The functional currencies of the bank's operations are as follows:

- Sultanate of Oman: Rial Omani
- United Arab Emirates: UAE Dirham
- Egypt: US Dollar

The United States Dollar amounts shown in the financial statements have been translated from Rial Omani at an exchange rate of RO 0.385 to each US Dollar, and are shown for the convenience of the reader only.

### 2.3 Statement of compliance

The financial statements of the bank have been prepared in accordance with International Financial Reporting Standards (IFRS), applicable regulations of the Central Bank of Oman and applicable requirements of the Commercial Companies Law of Oman, as amended and the Capital Market Authority of the Sultanate of Oman.

The bank also prepares a separate set of financial statements for its Islamic Banking Window (IBW) in accordance with the requirements of Section 1.2 of Title 3 of the Islamic Banking Regulatory Framework ("IBRF") issued by CBO. The separate set of financial statements of its IBW are prepared in accordance with Financial Accounting Standards ("FAS") issued by Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"), the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Islamic Window (the "SSB") and other applicable requirements of CBO. The IBWs financial statements are then converted into International Financial Reporting Standards (IFRS) compliant financial statements and included in these financial statements. All inter branch balances and transactions have been eliminated.

The bank presents its statement of financial position broadly in order of liquidity.

### 2.4 Significant accounting judgments and estimates

In preparation of the bank's financial statements, management requires to make certain estimates and assumptions that affect the reported amount of financial assets and liabilities and the resultant allowances for impairment and fair values. 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 allowances required for impaired loans and receivables as well as allowances for impairment provision for unquoted investment securities. Estimates and judgments are continually evaluated and are based on historical experience and other factors including expectations of future events that are believed to be reasonable under the circumstances. The significant use of judgments and estimates are as follows:

## 2 Basis of preparation (continued)

### 2.4.1 Going concern

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

### 2.4.2 Financial Instruments (applicable from 1 January 2018)

Judgements made in applying accounting policies that have most significant effects on the amounts recognized in the financial statements of the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments which impact:

- Classification of financial assets: assessment of business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payment of principal and interest of the principal amount outstanding.
- Calculation of expected credit loss (ECL): changes to the assumptions and estimate on uncertainties that have a significant impact on ECL for the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments. The impact is mainly driven by inputs, assumptions and techniques used for ECL calculation under IFRS 9 methodology.

**Inputs, assumptions and techniques used for ECL calculation – IFRS 9 Methodology**

Key concepts in IFRS 9 that have the most significant impact and require a high level of judgment, as considered by the Bank while determining the impact assessment, are:

Assessment of significant increase in credit risk

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Bank compares the risk of default occurring over the expected life of the financial asset at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the bank's existing risk management processes.

The bank's assessment of significant increases in credit risk is being performed at least quarterly for each individual exposure based on three factors. If any of the following factors indicates that a significant increase in credit risk has occurred, the instrument will be moved from Stage 1 to Stage 2:

1. The bank has established thresholds for significant increases in credit risk based on movement in Probability of Default relative to initial recognition.
2. Additional qualitative reviews have been performed to assess the staging results and make adjustments, as necessary, to better reflect the positions which have significantly increased in risk.
3. IFRS 9 contains a rebuttable presumption that instruments which are 30 days past due have experienced a significant increase in credit risk.

Movements between Stage 2 and Stage 3 are based on whether financial assets are credit-impaired as at the reporting date. The determination of credit-impairment under IFRS 9 will be similar to the individual assessment of financial assets for objective evidence of impairment under IAS 39.

Movements between Stage 2 and Stage 3 are based on whether financial assets are credit-impaired as at the reporting date. The determination of credit-impairment under IFRS 9 will be similar to the individual assessment of financial assets for objective evidence of impairment under IAS 39.

Macroeconomic Factors, Forward Looking Information (FLI) and Multiple scenarios

The measurement of ECL for each stage and the assessment of significant increases in credit risk considers information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgment.

Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) inputs used to estimate Stage 1 and Stage 2 credit loss allowances are modelled based on the macroeconomic variables (or changes in macroeconomic variables), that are closely correlated with credit losses in the relevant portfolio. Each macroeconomic scenario used in the bank's ECL calculation will have forecasts of the relevant macroeconomic variables.

The bank estimation of ECL in Stage 1 and Stage 2 is a discounted probability-weighted estimate that considers a minimum of three future macroeconomic scenarios.

Scenarios are probability-weighted according to the bank best estimate of their relative likelihood based on historical frequency and current trends and conditions. Probability weights are updated on a quarterly basis (if required). All scenarios considered are applied to all portfolios subject to ECL with the same probabilities.

Notes to the Financial Statements
As at 31 December 2018

## 2 Basis of preparation (continued)

### 2.4.2 Financial Instruments (applicable from 1 January 2018) (continued)

Sensitivity assessment due to movement in each macro-economic variable and the respective weights under the three scenarios is periodically assessed by the bank.

In some instances, the inputs and models used for calculating ECLs may not always capture all characteristics of the market at the date of the financial statements. To reflect this, qualitative adjustments or overlays are occasionally made as temporary adjustments when such differences are significantly material. Such cases are subjected to the bank's Governance process for oversight.

Definition of default

The definition of default used in the measurement of ECL and the assessment to determine movement between stages is consistent with the definition of default used for internal credit risk management purposes. IFRS 9 does not define default, but contains a rebuttable presumption that default has occurred when an exposure is greater than 90 days past due.

Expected life

When measuring ECL, the bank must consider the maximum contractual period over which the bank is exposed to credit risk. All applicable contractual terms are considered when determining the expected life, including prepayment options and extension and rollover options. For certain revolving credit facilities that do not have a fixed maturity, the expected life is estimated based on the period over which the bank is exposed to credit risk on similar financial instruments and where the credit losses would not be mitigated by management actions.

Governance

In addition to the existing risk management framework, the bank has established an internal Committee to provide oversight to the IFRS 9 impairment process. The Committee comprises of senior representatives from Chief executive office, finance, risk management and internal audit and will be responsible for reviewing and approving key inputs and assumptions used in the bank's ECL estimates. It also assesses the appropriateness of the overall allowance results to be included in the bank's financial statements.

### 2.4.3 Impairment losses on loans and advances (applicable before 1 January 2018)

The bank reviews its individually significant loans and advances at each reporting date to assess whether an impairment loss should be recorded in the statement of comprehensive income. In particular, judgment by management is required in the estimation of the amount and timing of future cash flows when determining the impairment loss. In estimating these cash flows, the bank makes judgments about the borrower's financial situation and the net realisable value of collateral. These estimates are based on assumptions about a number of factors and actual results may differ, resulting in future changes to the allowance.

Loans and advances that have been assessed individually and found not to be impaired and all individually insignificant loans and advances are then assessed collectively, in groups of assets with similar risk characteristics, to determine whether provision should be made due to incurred loss events for which there is objective evidence but whose effects are not yet evident. The collective assessment takes account of data from the loan portfolio (such as credit quality, levels of arrears, credit utilisation, loan to collateral ratios etc.) and concentrations of risks.

### 2.4.4 Impairment of equity investments (applicable before 1 January 2018)

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

### 2.4.5 Fair value of financial instruments

Where the fair values of financial assets and financial liabilities recorded on the 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 derived from observable market data where possible, but where observable market data are not available, judgment is required to establish fair values.

### 2.4.6 Deferred tax assets

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

### 2.4.7 Investment Funds

The bank acts as fund manager and investment advisor to investment funds. For all funds managed by the bank, the investors (whose number ranges from 30 to 100) are able to vote by simple majority to remove the bank as fund manager without cause, and the bank's

## 2 Basis of preparation (continued)

### 2.4.7 Investment Funds (continued)

aggregate economic interest is in each case less than 5%. As a result, the bank has concluded that it acts as agent for the investors in all cases, and therefore has not consolidated these funds.

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations

For the year ended 31 December 2018, the bank has adopted all of the following new and revised standards and interpretations issued by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) of the IASB that are relevant to its operations and effective for periods beginning on 1 January 2018.

- IFRS 9 Financial Instruments
- IFRS 15 Revenue from Contracts with Customers
- IFRIC 22 Foreign Currency Transactions and Advance Consideration

The adoption of the above did not result in any changes to previously reported net profit or equity of the bank except as mentioned below.

**A. IFRS 9 Financial Instruments**

IFRS 9 has significant impact on the bank's financial statements and details are set out below:

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

As permitted by the transitional provisions of IFRS 9, the bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current year. Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have been applied only to the current year. The comparative year notes disclosures repeat those disclosures made in the prior year.

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

The key changes to the bank's accounting policies resulting from its adoption of IFRS 9 are summarised below.

Classification of financial assets and financial liabilities

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVTPL). IFRS 9 classification of financial assets is generally based on the business model in which a financial asset is managed and its contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

There were no changes to the classification and measurement of financial liabilities.

Impairment of financial assets

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Hedge accounting

IFRS 9 introduced a new hedge accounting model to simplify hedge accounting outcomes and provide a better linkage between an entity's risk management strategy, the rationale for hedging and the impact of hedging on the financial statements. Some of the key improvements in the standard impacting the bank include:

1. Hedge effectiveness – IFRS 9 standard requires that the hedge effectiveness assessment be forward-looking and does not prescribe defined effectiveness parameters. Under IAS 39, an entity had to test effectiveness both retrospectively and prospectively subject to 80 to 125 percent effectiveness requirement.

Notes to the Financial Statements
As at 31 December 2018

## 2 Basis of preparation (continued)

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations (continue)

**A. IFRS 9 Financial Instruments (continued)**

2. Hedge discontinuation. IFRS 9 standard provides that discontinuation of hedge accounting will only happen under specified circumstances. Under IAS 39, the bank may revoke the hedging relationship if it seems fit.

These changes have not had a material impact on the statement of comprehensive income of the bank. In addition, some of the basics of hedge accounting applicable to the bank under IAS 39 do not change as a result of IFRS 9 adoption.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
  - The determination of the business model within which a financial asset is held.
  - The designation and revocation of previous designations of certain financial assets as measured at FVTPL
  - For hedging relationships under IAS 39, determination of whether these qualify for hedge accounting in accordance with the criteria of IFRS 9, after taking into account any rebalancing of the hedging relationship on transition, shall be regarded as continuing hedging relationships.

The CBO has issued guidelines relating to implementation of IFRS 9. The relevant requirements relating to transition are set out below:

- Should the existing loan loss impairment computed in accordance with the requirements of IAS 39 and CBO guidelines be higher than the impairment allowance computed under IFRS 9, the related difference (net of tax) be transferred to a loan loss impairment reserve from retained earnings as of 1 January 2018.
- In the subsequent years, where the allowance for loan loss impairment computed in accordance with CBO requirements is higher than the allowance for loan loss impairment loss computed under IFRS 9, the difference (net of tax) should be transferred to the aforementioned loan loss impairment reserve from retained earnings.

The related impairment reserve will not be available for dividend distribution or for inclusion in the regulatory capital. Any subsequent utilisation of the impairment reserve would require prior approval of the CBO.

## 2 Basis of preparation (continued)

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations (continued)

**A. IFRS 9 Financial Instruments (continued)**

Impact of adopting IFRS 9

Set out below is the impact of initial application of IFRS 9 on the bank's financial statements:

| Fair value reserve USD'000 | Retained earnings USD'000 | | Retained earnings RO'000 | Fair value reserve RO'000 |
|---|---|---|---|---|
| (6,483) | 351,598 | **Closing balance under IAS 39 (31 December 2017)** | 135,365 | (2,496) |
| | | **Impact on reclassification and remeasurements** | | |
| 717 | (717) | Investment securities (debt and puttable instruments) from available-for-sale to those measured at fair value through profit or loss | (276) | 276 |
| (899) | 899 | Investment securities (equity) from available-for-sale to those measured at fair value through other comprehensive income | 346 | (346) |
| | | **Impact on recognition of Expected Credit Losses** | | |
| - | (953) | Due from banks | (367) | - |
| - | (59,442) | Expected credit losses under IFRS 9 for loan and advances at amortised cost including loan commitments and financial guarantees | (22,885) | - |
| - | (1,304) | Expected credit losses under IFRS 9 for debt securities at fair value through other comprehensive income and amortised cost | (502) | - |
| **(6,665)** | **290,081** | **Estimated adjusted opening balance under IFRS 9 on date of initial application of 1 January 2018** | **111,681** | **(2,566)** |

Expected credit loss / Impairment allowances

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

| 1 January 2018 USD'000 | Re-measurement USD'000 | 31 December 2017 USD'000 | | 31 December 2017 RO'000 | Re-measurement RO'000 | 1 January 2018 RO'000 |
|---|---|---|---|---|---|---|
| 338,499 | 35,821 | 302,678 | **Loans and advances to customers** | 116,531 | 13,791 | 130,322 |
| 953 | 953 | - | Due from banks | - | 367 | 367 |
| 1,304 | 1,304 | - | Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9 | - | 502 | 502 |
| 23,620 | 23,620 | - | Loan Commitments and Financial Guarantees | - | 9,094 | 9,094 |
| **364,376** | **61,698** | 302,678 | | 116,531 | **23,754** | **140,285** |

Notes to the Financial Statements
As at 31 December 2018

## 2 Basis of preparation (continued)

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations (continued)

**A. IFRS 9 Financial Instruments (continued)**

Classification and Measurement of Financial Instruments

The Bank performed a detailed analysis of its business models for managing financial assets as well as analysing their cash flow characteristics. The below table reconciles the original measurement categories and carrying amounts of financial assets in accordance with IAS 39 and the new measurement categories under IFRS 9 as at 31 December 2017.

*Amounts in RO'000*

| | | | | Impact of IFRS 9 | | |
|---|---|---|---|---|---|---|
| | Original classification under IAS 39 | New classification under IAS 39 | Original carrying amount RO'000 | Re-measurement RO'000 | Re-classification RO'000 | New carrying amount RO'000 |
| **Financial assets** | | | | | | |
| Cash and balances with central banks | Loans and receivables | Amortised cost | 383,111 | - | - | 383,111 |
| Due from banks | Loans and receivables | Amortised cost | 138,670 | (367) | - | 138,303 |
| Loans and advances to customers | Loans and receivables | Amortised cost | 2,653,871 | (13,791) | - | 2,640,080 |
| Investment securities – debt | Available-for-sale | FVOCI | 3,895 | - | - | 3,895 |
| Investment securities – debt | Available-for-sale | FVTPL | 7,767 | - | - | 7,767 |
| Investment securities – debt | Held-for-trading | Amortised cost | 55,771 | (98) | - | 55,673 |
| Investment securities – debt | Held-to-maturity | Amortised cost | 89,789 | (404) | - | 89,385 |
| Investment securities – equity | Available-for-sale | FVOCI | 25,898 | - | - | 25,898 |

*Amounts in USD'000*

| | | | | Impact of IFRS 9 | | |
|---|---|---|---|---|---|---|
| | Original classification under IAS 39 | New classification under IAS 39 | Original carrying amount RO'000 | Re-measurement RO'000 | Re-classification RO'000 | New carrying amount RO'000 |
| **Financial assets** | | | | | | |
| Cash and balances with central banks | Loans and receivables | Amortised cost | 995,094 | - | - | 995,094 |
| Due from banks | Loans and receivables | Amortised cost | 360,182 | (953) | - | 359,229 |
| Loans and advances to customers | Loans and receivables | Amortised cost | 6,893,171 | (35,821) | - | 6,857,351 |
| Investment securities – debt | Available-for-sale | FVOCI | 10,116 | - | - | 10,116 |
| Investment securities – debt | Available-for-sale | FVTPL | 20,174 | - | - | 20,174 |
| Investment securities – debt | Held-for-trading | Amortised cost | 144,860 | (255) | - | 144,605 |
| Investment securities – debt | Held-to-maturity | Amortised cost | 233,218 | (1,049) | - | 232,169 |
| Investment securities – equity | Available-for-sale | FVOCI | 67,268 | - | - | 67,268 |

Opening ECL allowance determined in accordance with IFRS 9 for the loan commitments and financial guarantees is amounted to RO 9,094 thousands. The aggregate opening ECL allowance including funded and unfunded exposure is amounted to RO 23,754 thousands.



## 2 Basis of preparation (continued)

### 2.5 Standards, amendments and interpretations effective in 2018 and relevant for the Bank's operations (continued)

**A. IFRS 9 Financial Instruments (continued)**

**Financial Liabilities**

There were no changes to the classification and measurement of financial liabilities.

**B. IFRS 15 Revenue from contracts with customers**

This standard on revenue recognition replaces IAS 11, 'Construction contracts', and IAS 18,'Revenue' and related interpretations.

IFRS 15 is more prescriptive, provides detailed guidance on revenue recognition and reduces the use of judgment in applying revenue recognition policies and practices as compared to the replaced IFRS and related interpretations.

Revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service.

The bank also operates a rewards programme which allows customers to accumulate points when they purchase products on the bank's credit cards. The points can then be redeemed for shopping rewards, cash back or air miles, subject to a minimum number of points being obtained.

The core principle of IFRS 15 is that an entity recognizes revenue as it transfers the promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

IFRS 15 also includes a comprehensive set of disclosure requirements that will result in an entity providing users of financial statements with comprehensive information about the nature, amount, timing and uncertainty of revenue and cash flows arising from the entity's contracts with customers.

The bank has assessed that the impact of IFRS 15 is not material on the financial statements of the bank as at the adoption date and the reporting date.

### 2.6 Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

**IFRS 16 – Leases:** The IASB issued IFRS 16 Leases (IFRS 16), which requires lessees to recognise assets and liabilities for most leases. The standard includes two recognition exemptions for lessees – leases of 'low-value' assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). For lessors, there is little change to the existing accounting in IAS 17 Leases. The new standard will be effective for annual periods beginning on or after 1 January 2019. IFRS 16 also requires lessees and lessors to make more extensive disclosures than under IAS 17. The bank is in the process of making a detailed assessment of the above standard.

## 3 Significant Accounting Policies

The bank has consistently applied the following accounting policies to all periods presented in these financial statements, except for the changes related to IFRS 9 as explained in note 2.5(A).

### 3.1 Financial instruments – initial recognition

**a. Date of recognition and initial measurement**

The bank initially recognises loans and advances, deposits, debt securities issued and subordinated liabilities on the date on which they originated. All other financial instruments (including regular-way purchases and sales of financial assets) are recognised on the trade date, which is the date on which the bank becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. When the fair value of financial instruments at initial recognition differs from the transaction price, the Bank accounts for the Day 1 profit or loss, as described below.

**b. 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 Bank recognises the difference between the transaction price and fair value in net trading income. In those cases where fair value is based on models for which some of the inputs are not observable, the difference between the transaction price and the fair value is deferred and is only recognised in profit or loss when the inputs become observable, or when the instrument is derecognised.

**c. Measurement categories of financial assets and liabilities**

From 1 January 2018, the Bank has applied IFRS 9 and classifies all of its financial assets based on the business model for managing the assets and the asset's contractual terms, measured at either:

- Fair value through profit or loss (FVTPL);

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.1 Financial instruments – initial recognition (continued)

- Fair value through other comprehensive income (FVOCI); or
- Amortised cost.

Before 1 January 2018, the Bank classified its financial assets as loans and receivables (amortised cost), FVPL, available-for-sale or held-to-maturity (amortised cost).

Financial liabilities, other than loan commitments and financial guarantees, are measured at amortised cost or at FVPL when they are held for trading and derivative instruments at the fair value designation

### 3.2 Financial assets and liabilities

### 3.2.1 Due from banks, Loans and advances to customers, Financial investments at amortised cost

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

- That the Bank intended to sell immediately or in the near term
- That the Bank, upon initial recognition, designated as at FVPL or as available-for-sale
- For which the Bank may not recover substantially all of its initial investment, other than because of credit deterioration, which were designated as available-for-sale.

From 1 January 2018, the Bank only measures due from banks, loans and advances to customers 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 interest (SPPI) on the principal amount outstanding.

The details of these conditions are outlined below.

On initial recognition of an equity investment that is not held for trading, the bank may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis. All other financial assets are classified as measured at FVTPL.

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

**Business model assessment**

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

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

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.

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

## 3 Significant Accounting Policies (continued)

### 3.2 Financial assets and liabilities (continued)

### 3.2.1 Due from banks, Loans and advances to customers, Financial investments at amortised cost (continued)

**Assessment whether contractual cash flows are solely payments of principal and interest ('SPPI')**

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

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

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

The Bank holds a portfolio of long-term fixed rate loans for which the Bank has the option to propose to revise the interest rate at periodic reset dates. These reset rights are limited to the market rate at the time of revision. The borrowers have an option to either accept the revised rate or redeem the loan at par without penalty. The Bank has determined that the contractual cash flows of these loans are solely payments of principal and interest because the option varies the interest rate in a way that is consideration for the time value of money, credit risk, other basic lending risks and costs associated with the principal amount outstanding.

Contractual terms that introduce a more than de minimise 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 interest on the amount outstanding. In such cases, the financial asset is required to be measured at FVPL.

### 3.2.2 Financial assets or financial liabilities held for trading

The Bank classifies financial assets or financial liabilities as held for trading when they have been purchased or issued primarily for short-term profit making through trading activities or form part of a portfolio of financial instruments that are managed together, for which there is evidence of a recent pattern of short-term profit taking. Held-for-trading assets and liabilities are recorded and measured in the statement of financial position at fair value. Changes in fair value are recognised in net trading income. Interest and dividend income or expense is recorded in net trading income according to the terms of the contract, or when the right to payment has been established.

### 3.2.3 Debt instruments at FVOCI (policy applicable from 1 January 2018)

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 SPPI test

These instruments largely comprise assets that had previously been classified as financial investments available-for-sale under IAS 39.

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

- interest revenue using the effective interest method;
- ECL and reversals; and
- foreign exchange gains and losses.

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

### 3.2.4 Equity instruments at FVOCI (Policy applicable from 1 January 2018)

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.

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.2 Financial assets and liabilities (continued)

### 3.2.4 Equity instruments at FVOCI (Policy applicable from 1 January 2018) (continued)

Gains and losses on these equity instruments are never recycled to profit. Dividends are recognised in profit or loss as other operating income 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.

### 3.2.5 Debt issued and other borrowed funds

After initial measurement, debt issued and other borrowed funds are subsequently measured at amortised cost. Amortised cost is calculated by taking into account any discount or premium on issue funds, and costs that are an integral part of the EIR. A compound financial instrument which contains both a liability and an equity component is separated at the issue date.

### 3.2.6 Financial assets and financial liabilities at fair value through profit or loss

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 FVPL 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) containing 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 assets and financial liabilities at FVPL are recorded in the statement of financial position at fair value. Changes in fair value are recorded in profit and loss with the exception of movements in fair value of liabilities designated at FVPL due to changes in the Bank's own credit risk. Such changes in fair value are recorded in the Own credit reserve through OCI and do not get recycled to the profit or loss. Interest earned or incurred on instruments designated at FVPL is accrued in interest income or interest expense, respectively, using the EIR, taking into account any discount/ premium and qualifying transaction costs being an integral part of instrument. Interest earned on assets mandatorily required to be measured at FVPL is recorded using contractual interest rate. Dividend income from equity instruments measured at FVPL is recorded in profit or loss as other operating income when the right to the payment has been established.

### 3.2.7 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 (within Provisions) 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 income statement, and – under IAS 39 – the best estimate of expenditure required to settle any financial obligation arising as a result of the guarantee, or – under IFRS 9 – an ECL provision.

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

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

The nominal contractual value of financial guarantees, letters of credit and undrawn loan commitments, where the loan agreed to be provided is on market terms, are not recorded on in the statement of financial position. The nominal values of these instruments together with the corresponding ECLs are disclosed in Note 6.

### 3.2.8 Financial liabilities

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognised



## 3 Significant Accounting Policies (continued)

### 3.2 Financial assets and liabilities (continued)

### 3.2.8 Financial liabilities (continued)

in profit or loss, under IFRS 9 fair value changes are generally presented as follows:

- the amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in OCI; and
- the remaining amount of change in the fair value is presented in profit or loss.

The amount presented separately in OCI related to changes in own credit risk of a designated financial liability at FVTPL are not recycled to profit or loss, even when the liability is derecognised and the amounts are paid. Instead, own credit gains and losses should be reclassified to retained earnings within equity upon derecognition of the relevant liability.

### 3.2.9 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either:

(i) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge);

(ii) hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge); or

(iii) hedges of a net investment in a foreign operation (net investment hedge).

The Bank makes use of derivative instruments to manage exposures to interest rate, foreign currency and credit risks, including exposures arising from highly probable forecast transactions and firm commitments. In order to manage particular risks, the bank applies hedge accounting for transactions which meet specified criteria. Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any such derivative instruments are recognised immediately in the statement of comprehensive income within 'Other operating income'.

Hedge documentation, effectiveness assessment, and discontinuation accounting disclosures are provided in Note 3.10.

**Fair value hedges**

For designated and qualifying fair value hedges, the cumulative change in the fair value of a hedging derivative is recognised in the profit or loss in other operating income. Meanwhile, the cumulative change in the fair value of the hedged item attributable to the risk hedged is recorded as part of the carrying value of the hedged item in the statement of financial position and is also recognised in the profit or loss in other operating income. If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. For hedged items recorded at amortised cost, the difference between the carrying value of the hedged item on termination and the face value is amortised over the remaining term of the original hedge using the recalculated EIR method. If the hedged item is derecognised, the unamortised fair value adjustment is recognised immediately in the profit or loss.

**Cash flow hedges**

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 equity in the cash flow hedge reserve. The ineffective portion of the gain or loss on the hedging instrument is recognised immediately in other operating income in the profit or loss.

When the hedged cash flow affects the profit or loss, the gain or loss on the hedging instrument is recorded in the corresponding income or expense line of the profit or loss. When the forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously recognised in the other comprehensive income are removed from the reserve and included in the initial cost of the asset or liability. When a hedging instrument expires, or 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 other comprehensive income at that time remains in other comprehensive income and is recognised when the hedged forecast transaction is ultimately recognised in the profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the profit or loss.

### 3.3 Reclassifications

From 1 January 2018, the Bank does not reclassify its financial assets subsequent to their initial recognition, except in the period after the bank changes its business model for managing financial assets. Financial liabilities are never reclassified. The Bank did not reclassify any of its financial assets or liabilities in 2017.

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.4 Derecognition of the financial assets and liabilities

**Financial assets**

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

- the rights to receive cash flows from the asset have expired; or
- the Bank 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 Bank has transferred substantially all the risks and rewards of the asset, or (b) the Bank has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Bank has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Bank's continuing involvement in the asset. In that case, the bank 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 Bank has retained. 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 Bank could be required to repay.

**Financial liabilities**

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 lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in profit or loss for the year.

### 3.5 Modifications of financial assets and financial liabilities

**Financial assets**

If the terms of a financial asset are modified, the bank evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, the original financial asset is derecognised and a new financial asset is recognised at fair value. If the cash flows are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the bank recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income. If such a modification is carried out because of financial difficulties of the borrower, then the gain or loss is presented together with impairment losses. In other cases, it is presented as interest income.

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

**Financial liabilities**

The bank derecognises a financial liability when its terms are modified and the cash flows of the modified liability are substantially different. In this case, a new financial liability based on the modified terms is recognised at either amortised cost or fair value. The difference between the carrying amount of the financial liability derecognised and the new financial liability with modified terms is recognised in the statement of income.

### 3.6 Impairment of financial assets (Policy applicable from 1 January 2018)

The Bank recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

- financial assets that are debt instruments;
- financial guarantee contracts issued; and
- loan commitments issued.

No impairment loss is recognised on equity investments. The bank measures loss allowances at an amount equal to lifetime ECL, except for other financial instruments on which credit risk has not increased significantly since their initial recognition which they are measured as 12-month ECL.

12-month ECL are the portion of ECL that result from default events on a financial instrument that are possible within the 12 months after the reporting date.

### 3.6.1 Measurement of ECL

ECL are a probability-weighted estimate of credit losses. They are measured as follows:

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

## 3 Significant Accounting Policies (continued)

### 3.6 Impairment of financial assets (Policy applicable from 1 January 2018) (continued)

### 3.6.1 Measurement of ECL (continued)

- financial assets that are credit-impaired at the reporting date: as the difference between the gross carrying amount and the present value of estimated future cash flows;
- undrawn loan commitments: as the present value of the difference between the contractual cash flows that are due to the Bank if the commitment is drawn down and the cash flows that the bank expects to receive; and
- financial guarantee contracts: the expected payments to reimburse the holder less any amounts that the bank expects to recover.

### 3.6.2 Overview of the ECL principles

The adoption of IFRS 9 has fundamentally changed the bank's financing loss impairment method by replacing incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Bank has been recording the allowance for expected credit losses for all financing exposure and other debt financial assets not held at FVPL, together with financing commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss (LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12 month ECL).

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

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

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

Based on the above process, the Bank groups its financing exposure into Stage 1, Stage 2, and Stage 3, as described below:

**Stage 1**

When financing is first recognised, the Bank recognises an allowance based on 12 month ECLs. Stage 1 financing exposure also include facilities where the credit risk has improved and the financing exposure has been reclassified from Stage 2.

**Stage 2**

When a financing exposure has shown a significant increase in credit risk since origination, the Bank records an allowance for the LTECLs. Stage 2 financing exposure also include facilities, where the credit risk has improved and the financing exposure has been reclassified from Stage 3.

**Stage 3**

Financing exposure considered credit-impaired. The bank records an allowance for the LTECLs.

At initial recognition of a financial asset, the bank recognises a loss allowance equal to 12-month expected credit losses. After initial recognition, the three stages under the proposals would be applied as follows:

**Stage 1**

Credit risk has not increased significantly since initial recognition – recognise 12-month expected credit losses.

**Stage 2**

Credit risk has increased significantly since initial recognition – recognise lifetime expected losses (this is recognising a provision earlier than under IAS 39 Financial assets: Recognition and Measurement) with revenue being calculated based on the gross amount of the asset.

**Stage 3**

There is objective evidence of impairment as at the reporting date to recognise lifetime expected losses, with revenue being based on the net amount of the asset (that is, based on the impaired amount of the asset).

### 3.6.3 The calculation of ECLs

The bank calculates ECLs based on a three probability-weighted scenarios to measure the expected cash shortfalls, discounted at an approximation to the EIR. A cash shortfall is the difference between the cash flows that are due in accordance with the contract and the cash flows that are expected to be received.

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

- PD – The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.6 Impairment of financial assets (Policy applicable from 1 January 2018) (continued)

### 3.6.3 The calculation of ECLs (continued)

- EAD – The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and profit, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued profit from missed payments.
- LGD–The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including from the realisation of any collateral, if any. It is usually expressed as a percentage of the EAD.

### 3.6.4 Presentation of allowance for ECL in the statement of financial position

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

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

### 3.6.5 Debt instruments measured at fair value through OCI

The ECLs for debt instruments measured at FVOCI do not reduce the carrying amount of these financial assets in the 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.

### 3.6.6 Purchased or originated credit impaired financial assets (POCI)

For POCI financial assets, the Bank only recognises the cumulative changes in LTECL since initial recognition in the loss allowance.

### 3.6.7 Credit cards and other revolving facilities

The bank's product offering includes a variety of corporate and retail overdraft and credit cards facilities, in which the Bank has the right to cancel and/or reduce the facilities with one day's notice. The Bank does not limit its exposure to credit losses to the contractual notice period, but, instead calculates ECL over a period that reflects the Bank's expectations of the customer behaviour, its likelihood of default and the Bank's future risk mitigation procedures, which could include reducing or cancelling the facilities. Based on past experience and the Bank's expectations, the period over which the Bank calculates ECLs for these products, is five years for corporate and seven years for retail products.

### 3.7 Restructured financial assets

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

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

### 3.8 Credit-impaired financial assets

At each reporting date, the Bank assesses whether financial assets carried at amortised cost and debt financial assets carried at FVOCI are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.



## 3 Significant Accounting Policies (continued)

### 3.8 Credit-impaired financial assets (continued)

Evidence that a financial asset is credit-impaired includes the following observable data:

- significant financial difficulty of the borrower or issuer;
- a breach of contract such as a default or past due event;
- the restructuring of a loan or advance by the Bank on terms that the Bank would not consider otherwise;
- it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
- the disappearance of an active market for a security because of financial difficulties.

A loan that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail loan that is overdue for 90 days or more is considered impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Bank considers the following factors.

- The market's assessment of creditworthiness as reflected in the bond yields.
- The rating agencies' assessments of creditworthiness.
- The country's ability to access the capital markets for new debt issuance.
- The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
- The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

### 3.9 Write-off

The Bank's accounting policy under IFRS 9 remains the same as it was under IAS 39. Loans and debt securities are written off (either partially or in full) when there is no realistic prospect of recovery. This is generally the case when the bank determines that the borrower does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the bank's procedures for recovery of amounts due.

### 3.10 Hedge documentation, effectiveness assessment, and discontinuation

At the inception of the hedge, the bank formally designates and documents the hedging relationship to which the bank wishes to apply hedge accounting, and the risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the Bank will assess whether the hedging relationship meets the hedge effectiveness requirements (including its analysis of the sources of hedge ineffectiveness and how it determines the hedge ratio). Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis at each reporting date or upon a significant change in the circumstances affecting the hedge effectiveness requirements, whichever comes first. The assessment relates to expectations about hedge effectiveness and is therefore only forward-looking.

A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- there is 'an economic relationship' between the hedged item and the hedging instrument;
- the effect of 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 hedged item that the Bank actually hedges and the quantity of the hedging instrument that the Bank actually uses to hedge that quantity of hedged item.

When the hedging instrument or instruments have been sold or terminated, or when a hedging relationship no longer meets the risk management objective or the criteria for hedge accounting, any cumulative gain or loss that has been recognised in other comprehensive income at that time remains in other comprehensive income and is recognised when the hedged forecast transaction is ultimately recognised in the profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to the profit or loss.

The Bank performs a hedge effectiveness assessment in a similar manner as at the inception of the hedging relationship and subsequently on every reporting period.

A hedging relationship is discontinued in its entirety when as a whole it ceases to meet the qualifying criteria of the hedging relationship. Voluntary discontinuation when the qualifying criteria are met is prohibited. In the event of discontinuation any subsequent changes in fair value of the hedging instrument are recognised in profit or loss. For effective fair value hedges of financial

## 3 Significant Accounting Policies (continued)

### 3.10 Hedge documentation, effectiveness assessment, and discontinuation (continued)

instruments with fixed maturities any adjustment arising from hedge accounting is amortised over the remaining term to maturity. For effective cash flow hedges any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the hedged transaction occurs. If the hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to profit or loss.

### 3.11 Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and other financial institutions, treasury bills and money market placements, deposits and certificates of deposit maturing within three months of the date of acquisition. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

### 3.12 Financial assets and financial liabilities designated at fair value through profit or loss (applicable before 1 January 2018)

Financial assets and financial liabilities classified in this category are designated by management on initial recognition when the following criteria are met:

- 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 assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- The financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recorded.

Financial assets and financial liabilities at fair value through profit or loss are recorded in the statement of financial position at fair value. Changes in fair value are recorded in 'other operating income'. Interest is earned or incurred is accrued in 'Interest income' or 'Interest expense', respectively, using the effective interest rate (EIR), while dividend income is recorded in 'Other operating income' when the right to the payment has been established.

### 3.13 Held-to-maturity (applicable before 1 January 2018)

Held-to-maturity financial investments are those which carry fixed or determinable payments and have fixed maturities and which the bank has the intention and ability to hold to maturity. After initial measurement, held-to-maturity financial investments are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortisation is included in 'Interest income' in the statement of comprehensive income. The losses arising from impairment of such investments are recognised in the statement of comprehensive income.

If the bank were to sell or reclassify more than an insignificant amount of held-to-maturity investments before maturity (other than in certain specific circumstances), the entire category would be tainted and would have to be reclassified as available-for-sale. Furthermore, the bank would be prohibited from classifying any financial asset as held to maturity during the following two years.

### 3.14 Available-for-sale investments (applicable before 1 January 2018)

Available-for-sale investments include equity and debt securities. Equity investments classified as available-for-sale are those which are neither classified as held-for-trading nor designated at fair value through profit or loss. Debt securities in this category are those which are intended to be held for an indefinite period of time and which may be sold in response to needs for liquidity or in response to changes in the market conditions.

The bank has not designated any loans or receivables as available-for-sale.

After initial measurement, available-for-sale financial investments are subsequently measured at fair value, unless fair value cannot be reliably determined in which case they are measured at cost less impairment. Fair value changes are reported as a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously reported as "cumulative changes in fair value" within equity, is included in the statement of profit or loss for the year. Interest earned whilst holding available-for-sale financial investments is reported as interest income using the EIR. Dividends earned whilst holding available-for-sale financial investments are recognised in the statement of profit or loss as 'Other operating income' when the right of the payment has been established. The losses arising from impairment





## 3 Significant Accounting Policies (continued)

### 3.14 Available-for-sale investments (applicable before 1 January 2018) (continued)

of such investments are recognised in the profit or loss for the year in 'Impairment losses on available-for-sale financial investments' and removed from the 'Available-for-sale reserve'.

### 3.15 Due from banks and loans and advances to customers (applicable before 1 January 2018)

Due from banks and loans and advances to customers are financial assets with fixed or determinable payments and fixed maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale. After initial measurement, amounts due from banks and loans and advances to customers are subsequently measured at amortised cost using the effective interest rate method, less allowance for impairment. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees and costs that are an integral part of the effective interest rate. The amortisation is included in 'Interest income' in the profit or loss for the year. The losses arising from impairment are recognised in the profit or loss for the year in 'Credit loss expense'.

### 3.16 Determination of fair values

A number of the bank's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on a number of accounting policies and methods. Where applicable, information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability. Details are set out in note 33.

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

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible to the Bank.

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

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

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

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1 — Quoted (unadjusted) market prices in active markets for identical assets or liabilities
- Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable
- Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

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

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

The Bank also compares each the changes in the fair value of each asset and liability with relevant external sources to determine whether the change is reasonable.

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

### 3.17 Premises and equipment

Premises and equipment are initially recorded at cost or deemed cost. Revaluations of buildings are carried out every five years on an open market value for existing use basis by an independent valuer. Net surpluses arising on revaluation are credited to a revaluation reserve, except

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.17 Premises and equipment (continued)

that a revaluation increase is recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense.

A decrease as a result of a revaluation is recognised as an expense, except that it is charged directly against any related revaluation surplus to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset. On disposal the related revaluation surplus is credited to retained earnings.

Land and capital work in progress are stated at cost and tested for impairment, if any. Depreciation is provided on a straight-line basis over the estimated useful lives of all premises and equipment other than freehold land, which is deemed to have an indefinite life, and capital work in progress.

The rates of depreciation are based upon the following estimated useful lives:

Buildings on freehold land: 25 to 40 years

Leasehold improvements: Over the lease terms 3 to 10 years

Motor vehicles: 4 years

Furniture: 3 to 10 years

Equipment: 5 to 20 years

The assets' residual values, useful lives and depreciation methods are reviewed and adjusted if appropriate at each statement of financial position date.

### 3.18 Collateral pending sale

The bank occasionally acquires real estate in settlement of certain loans and advances. Real estate is stated at the lower of the net realisable value of the related loans and advances and the current fair value of such assets. Gains or losses on disposal, and unrealised losses on revaluation, are recognised in the profit or loss for the year.

### 3.19 Deposits

All money market and customer deposits are carried at amortised cost using EIR.

### 3.20 Other borrowed funds

Other borrowings including subordinate private placements are recognised initially at their issue proceeds. Borrowings are subsequently stated at amortised cost; any difference between proceeds, net of transaction costs, and the redemption value is recognised in the profit or loss over the period of the borrowings using EIR.

### 3.21 Taxation – current and deferred

Taxation is provided for based on the relevant tax laws of the respective countries, in which the bank operates.

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the profit or loss for the year except to the extent that it relates to items recognised directly to other comprehensive income, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### 3.22 Fiduciary assets

Assets held in trust or in a fiduciary capacity are not treated as assets of the bank and accordingly are not included in these financial statements.

### 3.23 Provisions

Provisions are recognised when the bank has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be reliably measured.

### 3.24 Impairment of financial assets (applicable before 1 January 2018)

The Bank assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is an objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or



## 3 Significant Accounting Policies (continued)

### 3.24 Impairment of financial assets (applicable before 1 January 2018) (continued)

delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults. If such evidence exists, the impairment loss is recognised in the profit or loss for the year.

**Due from banks and loans and advances to customers**

For amounts due from banks and loans and advances to customers carried at amortised cost, the bank first assesses individually whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not yet been incurred). The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the profit or loss for the year. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate of the asset. Loans together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the bank. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a future write-off is later recovered, the recovery is credited to the 'Recoveries from loans and advances written off'.

The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of the bank's internal credit grading system that considers credit risk characteristics such as asset type, industry, geographical location, collateral type, past-due status and other relevant factors.

Future cash flows on a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the bank. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the years on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect, and are directionally consistent with, changes in related observable data from year to year (such as changes in unemployment rates, property prices, payment status, or other factors that are indicative of incurred losses in the bank and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

**Renegotiated loans**

Where possible, the bank seeks to restructure loans rather than to take possession of collateral. This may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due. Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. The loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

**Held-to-maturity financial investments**

For held-to-maturity investments the bank assesses individually whether there is objective evidence of impairment. If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows. The carrying amount of the asset is reduced and the amount of the loss is recognised in the profit or loss for the year.

Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3.24 Impairment of financial assets (applicable before 1 January 2018) (continued)

If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognised, any amounts formerly charged are credited to the 'Impairment losses on financial investments'.

**Available-for-sale financial investments**

For available-for-sale financial investments, the bank assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. For this purpose significant means 35% below cost, and prolonged mean quoted prices remaining or below cost for a period of 12 continuous months. Where there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the profit or loss – is removed from equity and recognised in the profit or loss for the year. Impairment losses on equity investments are not reversed through the profit or loss; increases in their fair value after impairment are recognised directly in equity.

In the case of debt instruments classified as available-for-sale, impairment is assessed based on the same criteria as financial assets carried at amortised cost. Interest continues to be accrued at the original effective interest rate on the reduced carrying amount of the asset and is recorded as part of 'Interest income'. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the profit or loss, the impairment loss is reversed through the profit or loss.

### 3.25 Perpetual Bond

The bank classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instrument. The bank's perpetual bonds are not redeemable by holders and bear an entitlement to distribution that is non-cumulative and at the discretion of the board of directors. Accordingly, they are presented as component within equity.

### 3.26 Offsetting

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

### 3.27 Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

**Interest and similar income and expense**

Under both IFRS 9 and IAS 39, interest income is recorded using the effective interest rate (EIR) method for all financial instruments measured at amortised cost and financial instruments designated at fair value through profit or loss. Interest income on interest bearing financial assets classified at FVOCI under IFRS 9, similar to interest bearing financial assets classified as available for-sale or held or maturity under IAS 39 are also recorded by using EIR method. The EIR is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or financial liability. The calculation takes into account all contractual terms of the financial instrument and includes any fees or incremental costs that are directly attributable to the instrument and are an integral part of the EIR, but not future credit losses.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the bank and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised.

The carrying amount of the financial asset or financial liability is adjusted if the bank revises its estimates of payments or receipts. The adjusted carrying amount is calculated based on the original EIR and the change in carrying amount is recorded as 'Other operating income'.

**Fee and commission income**

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



## 3 Significant Accounting Policies (continued)

### 3.27 Revenue recognition (continued)

**Fee income earned from services that are provided over a certain period of time**

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

Loan commitment fees for loans that are likely to be drawn down and other credit related fees are deferred (together with any incremental costs) and recognised as an adjustment to the EIR on the loan. When it is unlikely that a loan will be drawn down, the loan commitment fees are recognised over the commitment period on a straight line basis.

**Fee income from providing transaction services**

Fees arising from negotiating or participating in the negotiation of a transaction for a third party, such as the arrangement of the acquisition of shares or other securities or the purchase or sale of businesses, sale of insurance products are recognised on completion of the underlying transaction. Fees or components of fees that are linked to a certain performance are recognised after fulfilling the corresponding criteria.

**Dividend income**

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

### 3.28 Repurchase and resale agreements

Assets sold with a commitment to repurchase (repos) at a specified future date are recognised in the statement of financial position and are measured in accordance with accounting policies for trading securities or investment securities. The counterparty liability for amounts received under these agreements is included in due to banks and other financial institutions. The difference between sale and repurchase price is treated as interest expense and accrued over the life of the repo agreement. Assets purchased with a corresponding commitment to resell at a specified future date (reverse repos) are not recognised in the statement of financial position and the amounts paid under these agreements are included in deposits with banks and other financial institutions. The difference between purchase and resale price is treated as interest income and accrued over the life of the reverse repo agreement.

### 3.29 Leases

Operating lease payments are recognised as an expense in the statement of comprehensive income on a straight-line basis over the lease term.

### 3.30 Staff terminal benefits

The terminal benefits for employees in Oman are provided in accordance with the Sultanate of Oman's labour law. The end of service benefits for employees in UAE are provided for in accordance with the employees' contracts of employment and applicable requirements of the UAE labour laws. For Egyptian employees the terminal benefits are provided in accordance with the Egyptian social security law.

### 3.31 Segment reporting

The Bank's segmental reporting is based on the following operating segments: retail banking, wholesale banking, commercial banking, head office and islamic. Segment results are reported to the Chief Executive Officer of the bank, (being the chief operating decision maker) and include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

### 3.32 Dividend on ordinary shares

Dividends on ordinary shares are recognised as a liability and deducted from equity when they are approved by the bank's shareholders. Interim dividends are deducted from equity when they are paid.

Dividends for the year that are approved after the balance sheet date are dealt with as an event after the balance sheet date.

### 3.33 Directors' remuneration

The board of directors' remuneration is accrued within the limits specified by the Capital Market Authority and the requirements of the Commercial Companies Law of the Sultanate of Oman.

### 3.34 Impairment of non-financial assets

The carrying amount of the Bank's non-financial assets, other than investment property and deferred tax assets are reviewed at each reporting date to determine whether there is any indication whether there is any indication of impairment. An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is reversed, only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss has been recognised.

## 3 Significant Accounting Policies (continued)

### 3.35 Earnings per share

The Bank presents basic and diluted earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares, which comprises convertible notes.

### 3.36 Foreign currency translation

(i) Transactions in foreign currencies are translated into Rial Omani at exchange rates ruling at the value dates of the transactions.

(ii) Monetary assets and liabilities denominated in foreign currencies are translated into Rial Omani at exchange rates ruling at the reporting date. The foreign currency gain or loss on monetary items is the difference between amortised costs in the Rial Omani at the beginning of the period, adjusted for effective interest and payments during the period and the amortised costs in foreign currency translated at the exchange rate at the end of the period. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

(iii) Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to Rial Omani at the exchange rate at the date that the fair value was determined. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

### 3.37 Acceptances

Acceptances are disclosed on the statement of financial position under other assets with corresponding liability disclosed under other liabilities. Therefore, there is no off-balance sheet commitment for acceptances.

### 3(A) Classification of Assets and Liabilities

The classification of assets and liabilities by accounting categorisation was as follows:

| Particulars | Classification under IFRS 9 | Carrying amount as at 31 December 2018 RO'000 | Carrying amount as at 31 December 2017 RO'000 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash and balances with central banks | Amortised cost | 315,055 | 383,111 |
| Due from banks (Net) | Amortised cost | 98,064 | 138,670 |
| Loans and advances and financing activities to customers (Net) | Amortised cost | 2,809,707 | 2,653,871 |
| Investment securities – debt (Net) | Amortised cost, FVOCI & FVTPL | 198,764 | 157,222 |
| Investment securities – equity | FVOCI & FVTPL | 32,385 | 25,898 |
| Other assets | Amortised cost | 54,137 | 43,084 |
| Derivatives with positive fair value | FVTPL | 450 | 2,701 |
| **Financial liabilities** | | | |
| Due to banks | Amortised cost | 155,949 | 125,757 |
| Customer deposits | Amortised cost | 2,452,382 | 2,461,267 |
| Euro medium term notes | Amortised cost | 307,148 | 230,906 |
| Subordinated debt | Amortised cost | 17,000 | 25,000 |
| Derivatives with negative fair value | FVTPL | 1,271 | 2,974 |
| Other liabilities | Amortised cost | 92,263 | 70,373 |



Notes to the Financial Statements
As at 31 December 2018

## 3 Significant Accounting Policies (continued)

### 3(A) Classification of Assets and Liabilities (continued)

| Particulars | Classification under IFRS 9 | Carrying amount as at 31 December 2018 USD'000 | Carrying amount as at 31 December 2017 USD'000 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash and balances with central banks | Amortised cost | 818,325 | 995,094 |
| Due from banks | Amortised cost | 254,712 | 360,182 |
| Loans and advances to customers | Amortised cost | 7,297,940 | 6,893,171 |
| Investment securities – debt | Amortised cost, FVOCI & FVTPL | 516,270 | 408,368 |
| Investment securities – equity | FVOCI & FVTPL | 84,117 | 67,268 |
| Other assets | Amortised cost | 140,616 | 111,906 |
| Derivatives with positive fair value | FVTPL | 1,169 | 7,016 |
| **Financial liabilities** | | | |
| Due to banks | Amortised cost | 405,062 | 326,642 |
| Customer deposits | Amortised cost | 6,369,823 | 6,392,901 |
| Euro medium term notes | Amortised cost | 797,787 | 599,756 |
| Subordinated debt | Amortised cost | 44,156 | 64,935 |
| Derivatives with negative fair value | FVTPL | 3,301 | 7,725 |
| Other Liabilities | Amortised cost | 239,644 | 182,787 |

## 4 Cash and balances with Central Banks

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 133,449 | **148,153** | Cash | **57,039** | 51,378 |
| 621 | **5,696** | Treasury bills with Central Banks | **2,193** | 239 |
| 20,418 | - | Certificate of Deposit with Central Banks | - | 7,861 |
| 839,307 | **663,177** | Other balances with Central Banks | **255,323** | 323,133 |
| 993,795 | **817,026** | **Cash and cash equivalents** | **314,555** | 382,611 |
| 1,299 | **1,299** | Capital deposit with Central Bank of Oman | **500** | 500 |
| 995,094 | **818,325** | **Cash and balances with Central Banks** | **315,055** | 383,111 |

(i) At 31 December 2018, cash and balances with Central Bank of Oman included balances of RO 500,000 (2017: RO 500,000) as capital deposit. This cannot be withdrawn without the Central Bank of Oman approval.

(ii) Minimum cash reserve to be maintained with Central Bank of Oman as of 31 December 2018 amounted to RO 77 million (2017: RO 76 million).

(iii) ECL on the cash and balances with Central Banks is not material and accordingly no adjustment has been accounted by the Bank.

**Notes to the Financial Statements**
As at 31 December 2018

## 5 Due from banks and other money market placements (net)

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 49,000 | **34,000** | Loans and advances to banks | **13,090** | 18,865 |
| 193,260 | **133,854** | Placement with banks | **51,534** | 74,405 |
| 118,166 | **87,842** | Demand balances | **33,819** | 45,494 |
| 360,426 | **255,696** | **Due from banks and other money market placement** | **98,443** | 138,764 |
| (244) | **(984)** | Less: allowance for credit losses | **(379)** | (94) |
| 360,182 | **254,712** | **Net due from banks and other money market placement** | **98,064** | 138,670 |

Movement in allowances for the credit losses is set out below:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 177 | **244** | Balance at beginning of year | **94** | 68 |
| NA | **953** | Impact of adopting IFRS 9 (Note 2.5(a)) | **367** | NA |
| 177 | **1,197** | **Restated opening balance under IFRS 9** | **461** | 68 |
| 67 | **(213)** | Released/provided during the year | **(82)** | 26 |
| 244 | **984** | **Balance at end of year** | **379** | 94 |

There have been no significant changes in due from banks and other money market placements gross balances, which have contributed to significant changes to the ECL over the year.

The credit quality and the maximum exposure to credit risk based on bank's internal credit rating system and the year-end staging classification is disclosed in note 30.1 to the financial statements.

## 6 Loans, advances and financing activities for customers (net)

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 259,714 | **259,023** | Overdrafts | **99,724** | 99,990 |
| 3,533,208 | **3,641,273** | Personal loans | **1,401,890** | 1,360,285 |
| 152,805 | **127,862** | Loans against trust receipts | **49,227** | 58,830 |
| 105,254 | **67,332** | Bills discounted | **25,923** | 40,523 |
| 3,144,868 | **3,541,094** | Other loans | **1,363,321** | 1,210,774 |
| 7,195,849 | **7,636,584** | **Gross loans, advances and financing activities for customers** | **2,940,085** | 2,770,402 |
| (302,678) | **(338,644)** | Allowance for credit losses | **(130,378)** | (116,531) |
| 6,893,171 | **7,297,940** | **Net loans and advances** | **2,809,707** | 2,653,871 |

Gross loans, advances and financing activities for customers include RO 115 million due from related parties at 31 December 2018 (31 December 2017 – RO 139 million) (refer note 27).

## 6 Loans, advances and financing activities for customers (net) (continued)

The movement in the provision for impairment of loans, advances and financing activities for customers is set out below:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 254,584 | **302,678** | Balance at beginning of year | **116,531** | 98,015 |
| NA | **35,821** | Impact of adopting IFRS 9 (Note 2.5(a)) | **13,791** | NA |
| 254,584 | **338,499** | **Restated opening balance under IFRS 9** | **130,322** | 98,015 |
| 80,221 | **71,950** | Provided during the year | **27,701** | 30,885 |
| (7,810) | **(11,751)** | Recovered/ released during the year | **(4,524)** | (3,007) |
| (24,322) | **(60,044)** | Written off during the year | **(23,117)** | (9,364) |
| 5 | **(10)** | Translation difference | **(4)** | 2 |
| 302,678 | **338,644** | **Balance at end of year** | **130,378** | 116,531 |

Provided during the period includes contractual interest reserved for RO 9,342 thousands.

Recovered/released during the period includes recovery of reserved interest for RO 1,654 thousands.

All loans and advances require payment of interest based on agreed tenors, some at fixed rates and others at rates that re-price prior to maturity. Contractual interest reserved and recovery thereof is shown under net interest income and income from Islamic financing in the interim condensed statement of comprehensive income.

As of 31 December 2018 loans and advances on which interest is not being accrued or where interest has been reserved amounted to RO 141 million (31 December 2017 – RO 113 million).

The credit quality and the maximum exposure to credit risk based on bank's internal credit rating system and the year-end staging classification is disclosed in note 30.1 to the financial statements.

The table below analyses the concentration of gross loans and advances by various sectors:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 3,533,208 | **3,641,273** | Personal | **1,401,890** | 1,360,285 |
| 490,504 | **668,652** | Financial institutions | **257,431** | 188,844 |
| 690,314 | **591,730** | Service | **227,816** | 265,771 |
| 496,579 | **550,434** | Manufacturing | **211,917** | 191,183 |
| 379,699 | **504,242** | Wholesale and retail trade | **194,133** | 146,184 |
| 502,174 | **491,081** | Construction | **189,066** | 193,337 |
| 431,816 | **313,395** | Electricity, gas and water | **120,657** | 166,249 |
| 275,624 | **293,129** | Others | **112,855** | 106,115 |
| 30,166 | **246,969** | Transport and communication | **95,083** | 11,614 |
| 199,455 | **196,765** | Mining and quarrying | **75,755** | 76,790 |
| 148,865 | **124,802** | Import trade | **48,049** | 57,313 |
| 14,901 | **13,595** | Agriculture | **5,234** | 5,737 |
| 2,544 | **517** | Government | **199** | 980 |
| 7,195,849 | **7,636,584** | **Total Gross Loans** | **2,940,085** | 2,770,402 |

Notes to the Financial Statements
As at 31 December 2018

## 6 Loans, advances and financing activities for customers (net)

The geographic distribution of loans and advances to customers, based on the location of the borrower is as follows:

*Amounts in RO'000*

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 6,802,374 | **7,306,925** | Sultanate of Oman | **2,813,166** | 2,618,914 |
| 369,969 | **313,268** | United Arab Emirates | **120,608** | 142,438 |
| 392 | **384** | Egypt | **148** | 151 |
| 23,114 | **16,007** | Others | **6,163** | 8,899 |
| 7,195,849 | **7,636,584** | **Total** | **2,940,085** | 2,770,402 |

### 6.1 Impairment charge and provision held as of 31 December 2018

*Amounts in RO'000*

| | As per CBO Norms | As per IFRS 9 | Difference |
|---|---|---|---|
| Impairment Loss charged to profit and loss | 13,971 | 13,971 | - |
| Provisions required as per CBO norms/ held as per IFRS 9 | 114,163* | 140,571 | 26,408 |
| Gross non-performing loan ratio (percentage) | 3.36 | 3.36 | - |
| Net non-performing loan ratio (percentage) | 1.39 | 1.01 | (0.38) |

*Amounts in USD'000*

| | As per CBO Norms | As per IFRS 9 | Difference |
|---|---|---|---|
| Impairment Loss charged to profit and loss | 36,288 | 36,288 | - |
| Provisions required as per CBO norms/ held as per IFRS 9 | 296,528* | 365,119 | 68,591 |
| Gross non-performing loan ratio (percentage) | 3.36 | 3.36 | - |
| Net non-performing loan ratio (percentage) | 1.39 | 1.01 | (0.38) |

**Excludes contractual interest reserve amounting to RO 16,724 thousands (USD 43,440 thousands)*

## 6 Loans, advances and financing activities for customers (net) (continued)

### 6.2 Comparison of impairment provisions in accordance with IFRS 9 and regulatory provision under Central Bank of Oman's (CBO) requirement as at 31 December 2018

*Amounts in RO'000*

| Asset Classification as per CBO Norms | Asset Classification as per IFRS 9 | Gross Amount | Provision required as per CBO Norms | Provision held as per IFRS 9 | Difference between CBO provision required and provision held under IFRS 9 | Net Amount as per IFRS 9 | Reserve interest as per CBO norms |
|---|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) = (4)+(8)-(5) | (7) = (3)-(5) | (8) |
| Standard | Stage 1 | 2,264,336 | 32,073 | 14,480 | 17,593 | 2,249,856 | - |
| | Stage 2 | 397,651 | 4,474 | 12,557 | (8,083) | 385,093 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **2,661,987** | **36,547** | **27,038** | **9,510** | **2,634,949** | **-** |
| Special Mention | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | 137,580 | 3,553 | 14,824 | (11,271) | 124,787 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **129,060** | **3,553** | **14,824** | **(11,271)** | **124,787** | **-** |
| Substandard | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 11,701 | 2,230 | 4,076 | (1,619) | 7,625 | 228 |
| **Subtotal** | | **11,701** | **2,230** | **4,076** | **(1,619)** | **7,625** | **228** |
| Doubtful | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 32,374 | 12,740 | 15,234 | (1,663) | 17,140 | 831 |
| **Subtotal** | | **32,374** | **12,740** | **15,234** | **(1,663)** | **17,140** | **831** |
| Loss | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 96,444 | 59,094 | 68,639 | 6,120 | 27,805 | 15,665 |
| **Subtotal** | | **96,444** | **59,094** | **68,639** | **6,120** | **27,805** | **15,665** |
| Other items not covered under CBO circular BM 977 and related instructions | Stage 1 | 604,983 | - | 2,466 | (2,466) | 602,517 | - |
| | Stage 2 | 159,391 | - | 8,294 | (8,294) | 151,097 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **764,374** | **-** | **10,759** | **(10,759)** | **753,615** | **-** |
| | **Stage 1** | **2,869,319** | **32,073** | **16,945** | **15,128** | **2,852,374** | **-** |
| | **Stage 2** | **694,622** | **8,027** | **33,644** | **(25,617)** | **660,978** | **-** |
| | **Stage 3** | **140,519** | **74,063** | **89,982** | **805** | **50,536** | **16,724** |
| | **Total** | **3,704,459** | **114,163** | **140,571** | **(9,684)** | **3,563,888** | **16,724** |

**Notes to the Financial Statements**
As at 31 December 2018

## 6 Loans, advances and financing activities for customers (net) (continued)

### 6.2 Comparison of impairment provisions in accordance with IFRS 9 and regulatory provision under Central Bank of Oman's (CBO) requirement as at 31 December 2018 (continued)

*Amounts in USD'000*

| Asset Classification as per CBO Norms | Asset Classification as per IFRS 9 | Gross Amount | Provision required as per CBO Norms | Provision held as per IFRS 9 | Difference between CBO provision required and provision held under IFRS 9 | Net Amount as per IFRS 9 | Reserve interest as per CBO norms |
|---|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) = (4)+(8)-(5) | (7) = (3)-(5) | (8) |
| Standard | Stage 1 | 5,881,392 | 83,307 | 37,609 | 45,698 | 5,843,783 | - |
| | Stage 2 | 1,032,859 | 11,621 | 32,616 | (20,995) | 1,000,243 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **6,914,251** | **94,928** | **70,225** | **24,703** | **6,844,026** | **-** |
| Special Mention | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | 357,352 | 9,228 | 33,230 | (24,001) | 324,122 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **357,352** | **9,228** | **33,230** | **(24,001)** | **324,122** | **-** |
| Substandard | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 30,392 | 6,695 | 10,587 | (3,301) | 19,805 | 592 |
| **Subtotal** | | **30,392** | **6,695** | **10,587** | **(3,301)** | **19,805** | **592** |
| Doubtful | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 84,088 | 33,090 | 39,569 | (4,319) | 44,519 | 2,159 |
| **Subtotal** | | **84,088** | **33,090** | **39,569** | **(4,319)** | **44,519** | **2,159** |
| Loss | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 250,504 | 152,586 | 183,565 | 9,711 | 66,939 | 40,689 |
| **Subtotal** | | **250,504** | **152,586** | **183,565** | **9,711** | **66,939** | **40,689** |
| Other items not covered under CBO circular BM 977 and related instructions | Stage 1 | 1,571,384 | - | 6,404 | (6,404) | 1,564,980 | - |
| | Stage 2 | 414,002 | - | 21,542 | (21,542) | 392,460 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | - | **1,985,386** | **-** | **27,946** | **(27,946)** | **1,957,440** | **-** |
| Total | **Stage 1** | **7,452,776** | **83,307** | **44,013** | **39,294** | **7,408,763** | **-** |
| | **Stage 2** | **1,804,213** | **20,849** | **87,388** | **(66,538)** | **1,716,825** | **-** |
| | **Stage 3** | **364,983** | **192,371** | **233,721** | **2,091** | **131,263** | **43,440** |
| | **Total** | **9,621,973** | **296,528** | **365,121** | **(25,154)** | **9,256,851** | **43,440** |



## 6 Loans, advances and financing activities for customers (net) (continued)

### 6.3 Restructured loans

*Amounts in RO'000*

| Asset Classification as per CBO Norms | Asset Classification as per IFRS 9 | Gross carrying amount | Provision required as per CBO Norms | Provision held as per IFRS 9 | Difference between CBO provision required and provision held under IFRS 9 | Net carrying amount as per IFRS 9 | Reserve interest as per CBO norms |
|---|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) = (4)+(8)-(5) | (7) = (3)-(5) | (8) |
| Classified as performing | Stage 1 | 76,488 | 980 | 1,227 | (247) | 75,261 | - |
| | Stage 2 | 20,725 | 2,510 | 5,325 | (2,815) | 15,400 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **97,213** | **3,490** | **6,552** | **(3,062)** | **90,661** | **-** |
| Classified as non-performing | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 34,702 | 11,771 | 15,635 | (905) | 19,067 | 2,959 |
| **Subtotal** | | **34,702** | **11,771** | **15,635** | **(905)** | **19,067** | **2,959** |
| Total | **Stage 1** | **76,488** | **980** | **1,227** | **(247)** | **75,261** | **-** |
| | **Stage 2** | **20,725** | **2,510** | **5,325** | **(2,815)** | **15,400** | **-** |
| | **Stage 3** | **34,702** | **11,771** | **15,635** | **(905)** | **19,067** | **2,959** |
| | **Total** | **131,915** | **15,261** | **22,187** | **(3,967)** | **109,728** | **2,959** |

*Amounts in USD'000*

| Asset Classification as per CBO Norms | Asset Classification as per IFRS 9 | Gross carrying amount | Provision required as per CBO Norms | Provision held as per IFRS 9 | Difference between CBO provision required and provision held under IFRS 9 | Net carrying amount as per IFRS 9 | Reserve interest as per CBO norms |
|---|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) = (4)+(8)-(5) | (7) = (3)-(5) | (8) |
| Classified as performing | Stage 1 | 198,670 | 2,545 | 3,187 | (642) | 195,483 | - |
| | Stage 2 | 53,831 | 6,519 | 13,831 | (7,312) | 40,000 | - |
| | Stage 3 | - | - | - | - | - | - |
| **Subtotal** | | **252,501** | **9,065** | **17,018** | **(7,953)** | **235,483** | **-** |
| Classified as non-performing | Stage 1 | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - |
| | Stage 3 | 90,135 | 30,574 | 40,610 | (2,351) | 49,525 | 7,686 |
| **Subtotal** | | **90,135** | **30,574** | **40,610** | **(2,351)** | **49,525** | **7,686** |
| Total | **Stage 1** | **198,670** | **2,545** | **3,187** | **(642)** | **195,483** | **-** |
| | **Stage 2** | **53,831** | **6,519** | **13,831** | **(7,312)** | **40,000** | **-** |
| | **Stage 3** | **90,135** | **30,574** | **40,610** | **(2,351)** | **49,525** | **7,686** |
| | **Total** | **342,636** | **39,639** | **57,629** | **(10,304)** | **285,008** | **7,686** |

Notes to the Financial Statements
As at 31 December 2018

## 6 Loans, advances and financing activities for customers (net) (continued)

### 6.4 Movement in Expected credit losses (ECL)

| | Stage 1 RO' 000 | Stage 2 RO' 000 | Stage 3 RO' 000 | Total RO' 000 |
|---|---|---|---|---|
| **Exposure subject to ECL** | | | | |
| – Loans and advances and financing activities for customers | 2,264,335 | 535,231 | 140,519 | 2,940,085 |
| – Investment securities (debt) | 231,741 | - | - | 231,741 |
| – Loan commitments and financial guarantees | 429,929 | 159,391 | - | 589,320 |
| – Due from banks, central banks and other financial assets | 98,443 | - | - | 98,443 |
| | **3,024,448** | **694,622** | **140,519** | **3,859,589** |
| **Opening Balance–as at 1 January 2018** | | | | |
| – Loans and advances and financing activities for customers | 12,474 | 44,394 | 73,454 | 130,322 |
| – Investment securities (debt) | 502 | - | - | 502 |
| – Loan commitments and financial guarantees | 1,423 | 7,671 | - | 9,094 |
| – Due from banks, central banks and other financial assets | 461 | - | - | 461 |
| | **14,860** | **52,065** | **73,454** | **140,379** |
| **Net transfer between stages** | | | | |
| – Loans and advances and financing activities for customers | 4,232 | (10,677) | 6,445 | - |
| – Investment securities (debt) | - | - | - | - |
| – Loan commitments and financial guarantees | (1,198) | 1,198 | - | - |
| – Due from banks, central banks and other financial assets | - | - | - | - |
| | **3,034** | **(9,479)** | **6,445** | **-** |
| **Charge for the Period (net)** | | | | |
| – Loans and advances and financing activities for customers | (2,163) | (7,864) | 33,200 | 23,173 |
| – Investment securities (debt) | 89 | - | - | 89 |
| – Loan commitments and financial guarantees | 1,207 | (1,078) | - | 129 |
| – Due from banks, central banks and other financial assets | (82) | - | - | (82) |
| | **(949)** | **(8,942)** | **33,200** | **23,309** |
| **Write off for the period** | | | | |
| – Loans and Advances to Customers | - | - | (23,117) | (23,117) |
| | **-** | **-** | **(23,117)** | **(23,117)** |
| **Closing Balance–as at 31 December 2018** | | | | |
| – Loans and advances and financing activities for customers | **14,543** | **25,853** | **89,982** | **130,378** |
| – Investment securities (debt) | **591** | **-** | **-** | **591** |
| – Loan commitments and financial guarantees | **1,432** | **7,791** | **-** | **9,223** |
| – Due from banks, central banks and other financial assets | **379** | **-** | **-** | **379** |
| | **16,945** | **33,644** | **89,982** | **140,571** |

## 6 Loans, advances and financing activities for customers (net) (continued)

### 6.4 Movement in Expected credit losses (ECL)(continued)

| | Stage 1 USD' 000 | Stage 2 USD' 000 | Stage 3 USD' 000 | Total USD' 000 |
|---|---|---|---|---|
| **Exposure subject to ECL** | | | | |
| – Loans and advances and financing activities for customers | 5,881,389 | 1,390,211 | 364,984 | 7,636,584 |
| – Investment securities (debt) | 601,925 | - | - | 601,925 |
| – Loan commitments and financial guarantees | 1,116,699 | 414,002 | - | 1,530,701 |
| – Due from banks, central banks and other financial assets | 255,696 | - | - | 255,696 |
| | **7,855,709** | **1,804,213** | **364,984** | **10,024,906** |
| **Opening Balance–as at 1 January 2018** | | | | |
| – Loans and advances and financing activities for customers | 32,400 | 115,309 | 190,790 | 338,499 |
| – Investment securities (debt) | 1,304 | - | - | 1,304 |
| – Loan commitments and financial guarantees | 3,696 | 19,925 | - | 23,621 |
| – Due from banks, central banks and other financial assets | 1,197 | - | - | 1,197 |
| | **38,597** | **135,234** | **190,790** | **364,621** |
| **Net transfer between stages** | | | | |
| – Loans and advances and financing activities for customers | 10,992 | (27,732) | 16,740 | - |
| – Investment securities (debt) | - | - | - | - |
| – Loan commitments and financial guarantees | (3,112) | 3,112 | - | - |
| – Due from banks, central banks and other financial assets | - | - | - | - |
| | **7,880** | **(24,620)** | **16,740** | **-** |
| **Charge for the Period (net)** | | | | |
| – Loans and advances and financing activities for customers | (5,618) | (20,426) | 86,233 | 60,189 |
| – Investment securities (debt) | 231 | - | - | 231 |
| – Loan commitments and financial guarantees | 3,135 | (2,801) | - | 334 |
| – Due from banks, central banks and other financial assets | (213) | - | - | (213) |
| | **(2,465)** | **(23,227)** | **86,233** | **60,541** |
| **Write off for the period** | | | | |
| – Loans and Advances to Customers | - | - | (60,044) | (60,044) |
| | **-** | **-** | **(60,044)** | **(60,044)** |
| **Closing Balance–as at 31 December 2018** | | | | |
| – Loans and advances and financing activities for customers | **37,774** | **67,151** | **233,719** | **338,644** |
| – Investment securities (debt) | **1,535** | **-** | **-** | **1,535** |
| – Loan commitments and financial guarantees | **3,719** | **20,236** | **-** | **23,955** |
| – Due from banks, central banks and other financial assets | **984** | **-** | **-** | **984** |
| | **44,012** | **87,387** | **233,719** | **365,118** |

Notes to the Financial Statements
As at 31 December 2018

## 7 Financial Investments

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| | | **Fair value through profit and loss** | | |
| | | **Quoted investments–Oman** | | |
| - | 12,660 | Banking and investment sector | 4,874 | - |
| - | 12,660 | | 4,874 | - |
| | | **Quoted investments- Foreign** | | |
| - | 1,044 | Banking and investment sector | 402 | - |
| - | 1,044 | | 402 | - |
| | | **Unquoted investments** | | |
| - | 5,626 | Banking and investment sector | 2,166 | - |
| - | 647 | Service sector | 249 | - |
| - | 6,273 | | 2,415 | - |
| - | 19,977 | **Total Fair value through profit and loss** | 7,691 | - |
| | | **Held for trading** | | |
| | | **Quoted investments–Oman** | | |
| 143,431 | - | Government development bonds | - | 55,221 |
| 1,429 | - | Banking and investment sector | - | 550 |
| 144,860 | - | | - | 55,771 |
| 144,860 | - | **Total held for trading** | - | 55,771 |
| | | **Total FVOCI – Equity investments** | | |
| | | **Quoted investments–Oman** | | |
| - | 5,280 | Manufacturing sector | 2,033 | - |
| - | 51,590 | Service sector | 19,862 | - |
| - | 56,870 | | 21,895 | - |
| | | **Quoted investments- Overseas** | | |
| - | 7,945 | Banking and investment sector | 3,059 | - |
| - | 7,945 | | 3,059 | - |
| | | **Unquoted investments** | | |
| - | 766 | Banking and investment sector | 295 | - |
| - | 94 | Service sector | 36 | - |
| - | 860 | | 331 | - |
| - | 65,675 | **Total FVOCI – Equity instruments** | 25,285 | - |
| | | **Debt instruments measured at FVOCI** | | |
| | | **Quoted investments–Oman** | | |
| - | 8,808 | Government Development Bonds | 3,391 | - |
| - | 8,808 | **Total FVOCI – Debt instruments** | 3,391 | - |

## 7 Financial Investments (continued)

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| | | **Available for sale** | | |
| | | **Quoted investments–Oman** | | |
| 5,904 | - | Manufacturing sector | - | 2,273 |
| 54,704 | - | Service sector | - | 21,061 |
| 10,117 | - | Government Development Bonds | - | 3,895 |
| 70,725 | - | | - | 27,229 |
| | | **Quoted investments–Foreign** | | |
| 6,602 | - | Banking and investment sector | - | 2,542 |
| 6,602 | - | | - | 2,542 |
| | | **Unquoted investments** | | |
| 19,345 | - | Banking and investment sector | - | 7,448 |
| 886 | - | Service sector | - | 341 |
| 20,231 | - | | - | 7,789 |
| 97,558 | - | **Total available for sale** | - | 37,560 |
| | | **Investment measured at amortised cost** | | |
| | | **Quoted investments–Oman** | | |
| - | 436,270 | Government Development Bonds | 167,964 | - |
| - | 7,792 | Government Sukuk | 3,000 | - |
| - | 11,272 | Banking and investment sector | 4,340 | - |
| - | 15,000 | Manufacturing sector | 5,775 | - |
| - | 24,260 | Service sector | 9,340 | - |
| - | 494,594 | | 190,419 | - |
| | | **Quoted investments–Foreign** | | |
| - | 12,868 | Government Development Bonds | 4,954 | - |
| - | 12,868 | | 4,954 | - |
| - | 507,462 | **Total amortised cost** | 195,373 | - |
| | | **Held-to-maturity** | | |
| | | **Quoted investments–Oman** | | |
| 199,963 | - | Government Development Bonds | - | 76,986 |
| 15,000 | - | Manufacturing sector | - | 5,775 |
| 214,963 | - | | - | 82,761 |
| | | **Quoted investments- Overseas** | | |
| 5,112 | - | Banking and investment sector | - | 1,968 |
| 13,143 | - | Government Development Bonds | - | 5,060 |
| 18,255 | - | | - | 7,028 |
| 233,218 | - | **Total held-to-maturity** | - | 89,789 |
| NA | (1,535) | **Less: Impact of adopting IFRS9 (Note 2.5(a))** | (591) | NA |
| 475,636 | 600,387 | **Total financial investments** | 231,149 | 183,120 |

Notes to the Financial Statements
As at 31 December 2018

## 7 Financial Investments (continued)

Movement in allowances for the credit losses for debt securities at fair value through other comprehensive income and amortised cost:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| NA | **NA** | Balance at beginning of year | **NA** | NA |
| NA | **1,304** | Impact of adopting IFRS 9 (Note 2.5(a)) | **502** | NA |
| NA | **1,304** | **Restated opening balance under IFRS 9** | **502** | NA |
| NA | **231** | Provided during the year | **89** | NA |
| NA | **1,535** | **Balance at end of year (Note 2.5(a))** | **591** | NA |

### Details of significant investments

Details of investments exceeding 10% of the carrying value of the bank's investment portfolio are as follows:

| Bank's portfolio % | Carrying value USD'000 | | Bank's portfolio % | Carrying value RO'000 |
|---|---|---|---|---|
| | | **2018** | | |
| **79.2%** | **475,584** | **Government Development Bonds-Oman** | **79.2%** | **183,100** |
| | | 2017 | | |
| 74.3% | 353,511 | Government Development Bonds-Oman | 74.3% | 136,102 |

In 2018, the Bank received dividends of RO 1.25 million from its FVOCI equities (2017: RO 1.34 million for available-for-sale securities), recorded as other operating income.

The Bank has designated its equity investments previously classified as available-for-sale as equity investments at FVOCI on the basis that these are not held for trading.

There have been no significant changes in debt instruments measured at FVOCI gross balances, which have contributed to significant changes to the ECL over the year.

The fair value of the Bank's debt instruments measured at FVOCI by credit risk, based on the Bank's internal credit rating system and year-end stage classification are disclosed in note 30.1 to the financial statements.

The credit rating profile of investment debt securities, based on the lowest rating assigned by the major international rating agencies, was as follows:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 5,112 | **24,260** | Rated | **9,340** | 1,968 |
| 29,571 | **13,930** | Unrated | **5,363** | 11,385 |
| 353,511 | **478,080** | Sovereign | **184,061** | 136,102 |
| 388,194 | **516,270** | **Total** | **198,764** | 149,455 |

## 8 Premises and Equipment

| | Freehold land and buildings and leasehold improvements RO'000 | Motor vehicles, furniture and equipment RO'000 | Capital work in progress RO'000 | Total RO'000 |
|---|---|---|---|---|
| **Reconciliation of carrying amount:** | | | | |
| Balance as at 1 January 2018, net of accumulated | | | | |
| Depreciation | 51,249 | 12,486 | 2,060 | 65,795 |
| Additions | 14 | 1,175 | 1,855 | 3,044 |
| Disposals | (4) | (12) | (4) | (20) |
| Transfers | 613 | 1,032 | (1,645) | - |
| Translation difference | (2) | - | - | (2) |
| Depreciation | (1,816) | (2,641) | - | (4,457) |
| **Balance at 31 December 2018, net of accumulated depreciation** | **50,054** | **12,040** | **2,266** | **64,360** |
| **Balance at 31December 2018, net of accumulated depreciation – USD'000** | **130,010** | **31,273** | **5,886** | **167,169** |
| At cost | 62,087 | 41,633 | 2,266 | 105,986 |
| At revaluation | 4,385 | - | - | 4,385 |
| Accumulated depreciation | (16,418) | (29,593) | - | (46,011) |
| **Net carrying value at 31 December 2018** | **50,054** | **12,040** | **2,266** | **64,360** |
| **Net carrying value at 31 December 2018 – USD'000** | **130,010** | **31,273** | **5,886** | **167,169** |
| At cost 1 January 2017 | 62,353 | 41,420 | 2,060 | 105,833 |
| At revaluation | 4,385 | - | - | 4,385 |
| Accumulated depreciation | (15,489) | (28,934) | - | (44,423) |
| **Net carrying value at 31 December 2017** | **51,249** | **12,486** | **2,060** | **65,795** |
| **Net carrying value at 31 December 2017 – USD'000** | **133,114** | **32,431** | **5,351** | **170,896** |

Land and buildings above includes owned land and buildings at net carrying value of RO 48.66 million-USD 126.39 million, (2017 – RO 49.77 million- USD 129.27 million) out of which freehold land at a cost of RO 8.56 million – USD 22.22 million (2017 – RO 8.56 million – USD 22.22 million) is not depreciated and not re-valued.

The bank has a policy to revalue its owned buildings at the end of every five years. In accordance with Bank's policy, three buildings on freehold land were re-valued at their open market value by an independent professional valuer, during 2015. Should the buildings on freehold land be carried at cost less depreciation, the net carrying amount would have been RO 38.33 million – USD 99.56 million (2017 –RO 39.32 million – USD 102.13 million).

Notes to the Financial Statements
As at 31 December 2018

## 9 Other assets

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 42,475 | **66,138** | Interest receivable and others | **25,464** | 16,353 |
| 7,016 | **1,169** | Positive fair value of derivatives (note 34) | **450** | 2,701 |
| 65,384 | **72,570** | Customers' indebtedness for acceptances | **27,939** | 25,173 |
| 4,047 | **1,906** | Deferred tax (note 14) | **734** | 1,558 |
| 118,922 | **141,783** | **Total** | **54,587** | 45,785 |

## 10 Due to banks and other money market deposits

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 317,073 | **390,610** | Borrowings | **150,385** | 122,073 |
| 9,569 | **14,452** | Other balances | **5,564** | 3,684 |
| 326,642 | **405,062** | **Total** | **155,949** | 125,757 |

## 11 Customers' deposits and unrestricted investment accounts

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 2,281,309 | **2,262,068** | Current accounts | **870,896** | 878,304 |
| 1,513,041 | **1,515,555** | Savings accounts | **583,489** | 582,521 |
| 2,598,551 | **2,592,200** | Term deposits | **997,997** | 1,000,442 |
| 6,392,901 | **6,369,823** | **Total** | **2,452,382** | 2,461,267 |

## 12 Euro medium term notes

The Bank issued a 5-year, USD 600 million Regulation S in October 2014. These notes mature in October 2019.

Subsequently during 2018 the Bank concluded a further issuance of USD 500 million and simultaneously increased the programme size to USD 1,500 million. The bank also bought back USD 300 million from the issuance made in year 2014.

As a result of the above fresh issuance and buyback the amounts disclosed in the balance sheet comprise the following:

| Particular | Amount |
|---|---|
| Issuance made in year 2014 maturing in 2019 | 300 million |
| Issuance made in year 2018 maturing in 2023 | 500 million |
| **Total** | **800 million** |

The bonds are listed on the Irish Stock Exchange and are governed by English law. The carrying amount of EMTN is stated after taking into account the amount of MTM value of the fair value hedge. (Refer note 34).

## 13 Other liabilities

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 112,647 | **137,826** | Interest payable and others | **53,063** | 43,369 |
| 4,756 | **5,294** | Staff entitlements | **2,038** | 1,831 |
| 65,384 | **72,567** | Liabilities under acceptances | **27,939** | 25,173 |
| - | **23,957** | Allowances for credit losses for loan Commitments and Financial Guarantees | **9,223** | - |
| 7,725 | **3,301** | Negative fair value of derivatives (note 34) | **1,271** | 2,974 |
| 190,512 | **242,945** | **Total** | **93,534** | 73,347 |
| | | **Staff entitlements are as follows:** | | |
| 4,073 | **4,580** | End of service benefits | **1,763** | 1,568 |
| 683 | **714** | Other liabilities | **275** | 263 |
| 4,756 | **5,294** | **Total** | **2,038** | 1,831 |
| | | **Movement in the end of service benefits liability are as follows:** | | |
| 3,956 | **4,073** | Liability as at 1 January | **1,568** | 1,523 |
| 1,353 | **1,496** | Expense recognised in the statement of comprehensive income | **576** | 521 |
| (1,236) | **(989)** | End of service benefits paid | **(381)** | (476) |
| 4,073 | **4,580** | **Liability as at 31 December** | **1,763** | 1,568 |

Movement in the allowance for credit losses–non-funded loans, advances and financing activities for customers:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| NA | **NA** | Balance at beginning of year | **NA** | NA |
| NA | **23,620** | Impact of adopting IFRS 9 (note (2.5(a)) | **9,094** | NA |
| NA | **23,620** | Restated opening balance under IFRS 9 | **9,094** | NA |
| NA | **14,435** | Provided during the year | **5,557** | NA |
| NA | **(14,098)** | Recovered/ released during the year | **(5,428)** | NA |
| NA | **23,957** | **Balance at year end** | **9,223** | NA |

## 14 Taxation

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| | | **Current tax expense** | | |
| 20,371 | **22,176** | Current year | **8,538** | 7,843 |
| (1,579) | **1,897** | Deferred tax adjustment | **730** | (608) |
| 18,792 | **24,073** | **Total** | **9,268** | 7,235 |

Notes to the Financial Statements
As at 31 December 2018

## 14 Taxation (continued)

The Bank is liable to income tax at the following rates:

- Sultanate of Oman: 15% of consolidated taxable income (2017: 15% of consolidated taxable income)
- United Arab Emirates: 20% of taxable income
- Egypt: 22.50% of taxable income

Set out below is reconciliation between income tax calculated on accounting profits with income tax expense for the year:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 133,146 | **155,522** | Accounting profit | **59,876** | 51,261 |
| 19,972 | **23,328** | Tax at applicable rate | **8,981** | 7,689 |
| 1,962 | **1,787** | Non-deductible expenses | **688** | 755 |
| (4,025) | **(2,542)** | Tax exempt revenues | **(979)** | (1,549) |
| 2,462 | **(397)** | Others | **(152)** | 948 |
| 20,371 | **22,176** | **Total** | **8,538** | 7,843 |

The Bank's liabilities for taxation in the Sultanate of Oman have been assessed up to the year ended 31 December 2013.

The tax assessments of the Egypt operations in respect of the different taxes applicable are at different stages of completion with the respective tax authorities. The bank's liability in respect of its branches in UAE has been agreed with the tax authorities up to 31 December 2017.

### Tax liability

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 20,371 | **22,176** | Income tax and other taxes – Current year | **8,538** | 7,843 |
| (70) | **4,886** | Income tax and other taxes – Prior years | **1,881** | (27) |
| 20,301 | **27,062** | **Total** | **10,419** | 7,816 |

### Recognised deferred tax assets

Deferred tax assets are attributable to the following:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 3,843 | **1,948** | Deductible temporary differences relating to provisions and revaluation of buildings | **750** | 1,480 |
| 204 | **(42)** | FVOCI investments | **(16)** | 78 |
| 4,047 | **1,906** | **Total** | **734** | 1,558 |

## 14 Taxation (continued)

### Movement of deferred tax asset/ (liability)

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 2,151 | **4,047** | Balance at the beginning of the year | **1,558** | 828 |
| 1,579 | **(1,897)** | Created during the year | **(730)** | 608 |
| 317 | **(244)** | Tax effect of movement in FVOCI investments during the year | **(94)** | 122 |
| 4,047 | **1,906** | **Total** | **734** | 1,558 |

## 15 Subordinated Debt

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 127,532 | **64,935** | At 1 January | **25,000** | 49,100 |
| (62,597) | **(20,779)** | Repaid during the year | **(8,000)** | (24,100) |
| 64,935 | **44,156** | **Total** | **17,000** | 25,000 |

## 16 Share Capital

The Authorised share capital of the bank is 2,000,000,000 shares of RO 0.100 each (2017 – 2,000,000,000 of RO each). At 31 December 2018, 1,625,946,355 shares of RO 0.100 each (2017 – 1,548,520,338 shares of RO 0.100 each) have been issued and fully paid.

As of 31 December 2018, the following shareholders held 10% or more of the bank's capital:

| | Number of shares '000 | % Holding |
|---|---|---|
| The Commercial Bank of Qatar | **567,453** | **34.90%** |
| Suhail Bahwan Group (Holdings) L.L.C | **239,734** | **14.74%** |
| Civil Service Employee Pension Fund | **183,917** | **11.31%** |

The percentage shareholding is calculated based on the total shares of the bank outstanding at the reporting date.

## 17 Share Premium

The share premium of RO 34.5 million (USD 89.5 million) represents the premium collected on issue of 10 million shares by the bank through a private placement for RO 4.45 (USD 11.56) per share. This was approved by the Bank's shareholders at the Bank's Extraordinary General Meeting held in 2005 at which time the face value of the Bank's share was RO 1.

## 18 Legal Reserve

The legal reserve, which is not available for distribution, is accumulated in accordance with the requirements of the Commercial Companies Law of Oman and the Union Law No. 10 of UAE. The annual appropriations must not be less than 10% of the profit for the year until such time that the respective reserve account balance amounts to at least one third of the share capital in Oman and half of the branch capital in UAE. At 31 December 2018, the legal reserve of Oman has reached one third of the issued capital.

Notes to the Financial Statements
As at 31 December 2018

## 19 Other non-distributable reserves

| | Available for sale reserve RO '000 | Revaluation reserve RO '000 | Subordinated debt reserve RO '000 | Total RO'000 |
|---|---|---|---|---|
| At 1 January 2018 | (2,496) | 4,385 | 21,600 | 23,489 |
| Impact of adopting IFRS 9 (note (2.5(a)) | | | | |
| Investment securities (debt and puttable instruments) from available-for-sale to those measured at fair value through profit or loss | 276 | - | - | 276 |
| Investment securities (equity) from available-for-sale to those measured at fair value through other comprehensive income | (346) | - | - | (346) |
| Restated opening balance under IFRS 9 | (2,566) | 4,385 | 21,600 | 23,419 |
| Net movement on available for sale investments | (2,184) | - | - | (2,184) |
| Tax effect of net losses on available for sale financial investments | (94) | - | - | (94) |
| Transfer to retained earnings | - | - | (8,000) | (8,000) |
| Transfer to subordinated fund reserve | - | - | 3,400 | 3,400 |
| **At 31 December 2018** | **(4,844)** | **4,385** | **17,000** | **16,541** |
| **At 31 December 2018 – In USD'000** | **(12,582)** | **11,390** | **44,156** | **42,964** |

(i) The revaluation reserve represents the surplus on revaluation of building and is not available for distribution until the related assets have been disposed off or used.

(ii) The subordinated debt reserve represents an annual transfer towards subordinated debt which is due to mature within the next five years period (note 15). The reserve is available for transfer back to retained earning upon maturity of the subordinated debt.

## 20 Tier 1 perpetual bond

The Bank, in 2015 issued Perpetual Tier 1 Capital Securities (the "Tier 1 Securities"), amounting to R.O 115,500,000. (USD 300,000,000)

The Tier 1 Securities constitute direct, unconditional, subordinated and unsecured obligations of the Bank and are classified as equity in accordance with IAS 32: Financial Instruments – Classification. The Tier 1 Securities do not have a fixed or final maturity date. They are redeemable by the bank at its sole discretion on 18 November 2020 (the "First Call Date") or on any interest payment date thereafter subject to the prior consent of the Central Bank of Oman.

The Tier 1 Securities bear interest on their nominal amount from the issue date to the First Call Date at a fixed annual rate of 7.875% which is the aggregate of margin and 5 year mid-swap rate that was prevailing at the time of issuance. The mid-swap rate will be reset at end of every fifth year. Interest is payable semi-annually in arrears and treated as deduction from equity. Interest is non-cumulative and payable at the Bank's discretion.

These securities form part of Tier 1 Capital of the bank and comply with Basel-3 and Central Bank of Oman regulations (BM 1114).

## 21 Dividends paid and proposed

The Board of Directors have proposed a cash dividend of RO 0.016 per share totalling RO 26 million (USD 0.042 per share totalling USD 67.5 million) for the year ended 31 December 2018, which is subject to the approval of the shareholders at the Annual General Meeting to be held in March 2019.

At the Annual General Meeting held in March 2018, a cash dividend of RO 0.015 per share totalling RO 23.2 million (USD 0.039 per share totalling USD 60.3 million) and stock dividend of RO 0.005 per share totalling RO 7.7 million (USD 0.013 per share totalling USD 20.1 million) for the year ended 31 December 2017 was approved and subsequently paid.

## 22 Contingent liabilities and commitments

To meet the financial needs of customers, the Bank enters into various irrevocable commitments and contingent liabilities. Even though these obligations may not be recognised on the statement of financial position, they do contain credit risk and are therefore part of the overall risk of the Bank.

Credit related commitments include commitments to extend credit, standby letters of credit and guarantees, which are designed to meet the requirements of the Bank's customers.

## 22 Contingent liabilities and commitments (continued)

Commitments to extend credit represent contractual commitments to make loans and revolving credits. Commitments generally have fixed expiration dates or other termination clauses and require the payment of a fee. Since commitments may expire without being drawn upon, the total contract amounts do not necessarily represent future cash requirements.

Standby letters of credit and guarantees commit the Bank to make payments on behalf of customers' contingent upon the failure of the customer to perform under the terms of the contract.

### 22.1 Contingent liabilities and commitments

As of the reporting date, commitments on behalf of customers for which there were corresponding customer liabilities consisted of the following:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 947,844 | **958,090** | Guarantees | **368,865** | 364,920 |
| 213,473 | **261,913** | Documentary letters of credit | **100,836** | 82,187 |
| 1,161,317 | **1,220,003** | **Total** | **469,701** | 447,107 |

The table below analyses the concentration of contingent liabilities by economic sector

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 563,143 | **500,629** | Construction | **192,742** | 216,810 |
| 113,205 | **162,452** | Others | **62,544** | 43,584 |
| 191,104 | **159,494** | Wholesale and Retail Trade | **61,405** | 73,575 |
| 91,525 | **136,312** | Financial Institutions | **52,480** | 35,237 |
| 111,610 | **129,918** | Manufacturing | **50,018** | 42,970 |
| 23,421 | **78,159** | Transport and Communication | **30,091** | 9,017 |
| 53,457 | **42,531** | Service | **16,375** | 20,581 |
| 9,335 | **7,994** | Mining & quarrying | **3,078** | 3,594 |
| 3,270 | **1,602** | Electricity, gas and water | **617** | 1,259 |
| 699 | **649** | Personal | **250** | 269 |
| 548 | **263** | Agriculture | **101** | 211 |
| 1,161,317 | **1,220,003** | **Total** | **469,701** | 447,107 |

Guarantees include RO 1.58 million – USD 4.1 million (Dec 2017: RO 0.29 million – USD 0.75 million) relating to non-performing loans.

Notes to the Financial Statements
As at 31 December 2018

## 22 Contingent liabilities and commitments (continued)

### 22.2 Commitments

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 422,927 | **310,699** | Undrawn commitment | **119,619** | 162,827 |
| 5,062 | **2,894** | Capital expenditure | **1,114** | 1,949 |
| 8,894 | **4,701** | Operating lease commitments | **1,810** | 3,424 |
| | | **Future minimum lease payments:** | | |
| 3,340 | **2,135** | Not later than one year | **822** | 1,286 |
| 5,554 | **2,566** | Later than one year and not later than five years | **988** | 2,138 |
| 8,894 | **4,701** | **Total** | **1,810** | 3,424 |

### 22.3 Branches

The Bank has deposited in the countries concerned, the following amounts of capital as support for its overseas branches. These amounts cannot be withdrawn without the approval of the Central Banks of the countries concerned.

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 88,584 | **88,584** | UAE branch | **34,105** | 34,105 |
| 50,000 | **50,000** | Egypt branches | **19,250** | 19,250 |
| 138,584 | **138,584** | **Total** | **53,355** | 53,355 |

### 22.4 Legal claims

By nature of the banking sector, litigation whether by or against the Bank is expected. In order to properly manage such litigation, the Bank has in place effective mechanism and controls. The Bank does not have any major/material litigation pending in a court of law in Oman or outside either instituted by or against the Bank, other than normal cases filed by or against customers in the normal course of business. However, there are certain unresolved legal claims filed against the Bank which are not expected to have any significant implication on the Bank's financial statements.

### 22.5 Fiduciary assets

The fair value of securities as of 31 December 2018 held on trust for customers amounts to RO 46.8 million – USD 121.6 million (2017 – RO 47.8 million – USD 124.2 million).

## 23 Interest income

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 366,971 | **363,569** | Interest from customers | **139,974** | 141,284 |
| 9,096 | **13,034** | Interest from banks | **5,018** | 3,502 |
| 13,221 | **19,903** | Investments | **7,663** | 5,090 |
| 389,288 | **396,506** | **Total** | **152,655** | 149,876 |

Interest bearing assets, other than investments earned interest at an overall effective annual rate of 5.29 % for the year ended 31 December 2018 (31 December 2017 – 5.13 %).

## 24 Interest expenses

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 107,327 | **115,270** | Interest to customers | **44,379** | 41,321 |
| 17,688 | **20,480** | Interest to banks | **7,885** | 6,810 |
| 18,130 | **28,060** | Euro medium term notes | **10,803** | 6,980 |
| 143,145 | **163,810** | **Total** | **63,067** | 55,111 |

For the year ended 31 December 2018, the average overall effective annual cost of bank's funds was 2.32 % (2017 – 1.97 %).

## 25 Other operating income

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 50,647 | **58,127** | Fees and commission income | **22,379** | 19,499 |
| (18) | **(18)** | Fees and commission expense | **(7)** | (7) |
| 50,629 | **58,109** | **Net fees and commissions** | **22,372** | 19,492 |
| 13,122 | **14,316** | Service charges | **5,512** | 5,052 |
| 4,829 | **306** | Profit on sale of investments | **118** | 1,859 |
| 14,630 | **16,185** | Net gains from foreign exchange dealings | **6,231** | 5,633 |
| 3,488 | **3,268** | Dividend income | **1,258** | 1,343 |
| 3,164 | **2,974** | Miscellaneous income | **1,145** | 1,218 |
| 89,862 | **95,158** | **Total** | **36,636** | 34,597 |

## 26 Other operating expenses

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 15,953 | **13,901** | Establishment costs | **5,352** | 6,142 |
| 41,691 | **34,213** | Operating and administration costs | **13,172** | 16,051 |
| 870 | **792** | Directors' remuneration and sitting fees | **305** | 335 |
| 58,514 | **48,906** | **Total** | **18,829** | 22,528 |

## 27 Related party transactions

In the ordinary course of business, the Bank conducts transactions with certain of its directors and/or shareholders and companies over which they have significant interest. The aggregate amounts of balances with such related parties are as follows:

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Principal shareholders RO'000 | Others RO'000 | Total RO'000 | Principal shareholders RO'000 | Others RO'000 | Total RO'000 |
| Loans and advances | - | 115,139 | 115,139 | - | 138,697 | 138,697 |
| Customers' deposits | 32,263 | 52,757 | 85,020 | 2,730 | 38,548 | 41,278 |
| Due from banks | 84 | 9,625 | 9,709 | 156 | 9,625 | 9,781 |
| Due to banks | 109 | - | 109 | 427 | - | 427 |
| Subordinated debt | 14,500 | - | 14,500 | 14,500 | 3,000 | 17,500 |
| Letter of credit, guarantees and acceptance | 523 | 45,152 | 45,675 | 3,057 | 8,765 | 11,822 |
| Standby revolving credit facility | 77,000 | - | 77,000 | 77,000 | - | 77,000 |
| Investment | 2,031 | - | 2,031 | 1,981 | - | 1,981 |
| The statement of comprehensive income includes the following amounts in relation to transactions with related parties: | | | | | | |
| Interest income | 33 | 7,177 | 7,210 | 40 | 6,275 | 6,315 |
| Commission income | 76 | 228 | 304 | 80 | 895 | 975 |
| Interest expense | 2,050 | 1,190 | 3,240 | 2,947 | 1,096 | 4,043 |
| Other expenses | - | 600 | 600 | - | 445 | 445 |

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Principal shareholders USD'000 | Others USD'000 | Total USD'000 | Principal shareholders USD'000 | Others USD'000 | Total USD'000 |
| Loans and advances | - | 299,062 | 299,062 | - | 360,252 | 360,252 |
| Customers' deposits | 83,800 | 137,031 | 220,831 | 7,091 | 100,125 | 107,216 |
| Due from banks | 218 | 25,000 | 25,218 | 405 | 25,000 | 25,405 |
| Due to banks | 283 | - | 283 | 1,109 | - | 1,109 |
| Subordinated debt | 37,662 | - | 37,662 | 37,662 | 7,792 | 45,454 |
| Letter of credit, guarantees and acceptance | 1,358 | 117,278 | 118,636 | 7,940 | 22,766 | 30,706 |
| Standby revolving credit facility | 200,000 | - | 200,000 | 200,000 | - | 200,000 |
| Investment | 5,275 | - | 5,275 | 5,145 | - | 5,145 |
| The statement of comprehensive income includes following amounts as relation to the transaction with related parties. | | | | | | |
| Interest income | 86 | 18,642 | 18,728 | 104 | 16,299 | 16,403 |
| Commission income | 197 | 592 | 789 | 208 | 2,325 | 2,533 |
| Interest expense | 5,325 | 3,091 | 8,416 | 7,655 | 2,847 | 10,502 |
| Other expenses | - | 1,558 | 1,558 | - | 1,156 | 1,156 |



Notes to the Financial Statements
As at 31 December 2018

## 27 Related party transactions (continued)

Details regarding senior management compensation are set out below:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| | | Salaries and other short term benefits | | |
| 8,309 | 7,322 | - Fixed | 2,819 | 3,199 |
| 3,894 | 4,008 | - Discretionary | 1,543 | 1,499 |
| 12,203 | 11,330 | Total | 4,362 | 4,698 |

## 28 Basic and diluted earnings per share

In the ordinary course of business, the bank conducts transactions with certain of its directors and/or shareholders and companies over which they have significant interest. The aggregate amounts of balances with such related parties are as follows:

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Net Profit after tax (RO'000s) | 50,608 | 44,026 |
| Less: Interest on tier 1 perpetual bond | (9,096) | (9,096) |
| Less: Withholding tax provision on tier 1 perpetual bond | (2,021) | - |
| Profit attributable to shareholders | 39,491 | 34,930 |
| **Weighted average number of shares outstanding during the year (in '000s)** | 1,625,946 | 1,625,946 |
| **Earnings per share (RO)** | 0.024 | 0.021 |

| | 2018 USD'000 | 2017 USD'000 |
|---|---|---|
| Net Profit after tax (USD'000s) | 131,448 | 114,353 |
| Less: Interest on tier 1 perpetual bond | (23,626) | (23,626) |
| Less: Withholding tax provision on tier 1 perpetual bond | (5,249) | - |
| Profit attributable to shareholders | 102,573 | 90,727 |
| **Weighted average number of shares outstanding during the year (in '000s)** | 1,625,946 | 1,625,946 |
| **Earnings per share (USD)** | 0.06 | 0.06 |

During the year 2018, the Bank issued bonus shares amounting to RO 7.7 million at RO 0.005 per share (USD 0.019 per share totalling USD 20 million). As the issue was without any consideration, the number of ordinary shares outstanding before the event is adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented.

No figure for diluted earnings per share has been presented, as the bank has not issued any instruments, which would have an impact on earnings per share when exercised.

Notes to the Financial Statements
As at 31 December 2018

## 29 Capital adequacy

The Bank maintains an actively managed capital base to cover risks inherent in the business. The adequacy of the bank's capital is monitored using, among other measures, the rules and ratios established by the Basel Committee on Banking Supervision and adopted by the Central Bank of Oman in supervising the Bank.

During the past year, the bank had complied in full with all its externally imposed capital requirements.

### Capital management

The primary objectives of the Bank's capital management are to ensure that the Bank complies with externally imposed capital requirements and that the bank maintains strong credit ratings and healthy capital ratios in order to support its business and to maximise shareholders' value.

The Bank 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 bank may adjust the amount of dividend payment to shareholders, return capital to shareholders or issue capital securities. The Capital Management Policy was revised during the year to incorporate the regulatory changes.

The international standard for measuring capital adequacy is the risk asset ratio, which relates capital to balance sheet assets and off balance sheet exposures weighted according to broad categories of risk.

The risk asset ratio calculated in accordance with the capital adequacy guidelines of the bank for International Settlement is as follows:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| | | **Capital base** | | |
| 1,043,086 | **1,010,312** | Common equity Tier 1 - shareholders' funds | **388,970** | 401,588 |
| 300,000 | **300,000** | Additional Tier 1 - capital | **115,500** | 115,500 |
| 101,896 | **94,127** | Tier 2 - subordinated debt and collective impairment provisions | **36,239** | 39,230 |
| 1,444,982 | **1,404,439** | **Total capital base** | **540,709** | 556,318 |
| | | **Risk weighted assets** | | |
| 7,445,255 | **7,820,239** | Credit risk | **3,010,792** | 2,866,423 |
| 655,779 | **644,896** | Operational risk | **248,285** | 252,475 |
| 228,543 | **169,130** | Market risk | **65,115** | 87,989 |
| 8,329,577 | **8,634,265** | **Total risk weighted assets** | **3,324,192** | 3,206,887 |
| 12.5% | **11.7%** | **CET 1 Ratio** | **11.7%** | 12.5% |
| 16.1% | **15.2%** | **Tier 1 Ratio** | **15.2%** | 16.1% |
| 17.3% | **16.3%** | **Risk asset ratio (Basel II norms)** | **16.3%** | 17.3% |

## 30 Risk management

Effective risk management is of primary importance for the Bank. The Bank's risk management process evaluates, monitors and manages the risks associated with the businesses the Bank conducts in line with the defined risk appetite. The Bank's key risks are credit risk, market risk, operational risk and strategic risk. The Bank operates on the guiding principles of three lines of defense i.e. Business, Independent control functions and internal audit. The risk management function is headed by the CRO with a team of risk professionals to manage specific risk functions.

### 30.1 Credit risk

Credit risk is the risk of potential loss in the event that the Bank's customers, clients or counterparties fail to honour their financial and contractual obligations to the bank. Credit risk is one of the most significant risks for the bank. The Bank has a robust credit risk framework and policies for each of the businesses it operates. The policies are aligned with the risk appetite and credit limits are set up based on the counter party risk rating, industry sector, and as per the guidelines of Central Bank of Oman.

#### Credit risk management

Credit Risk is managed within the regulatory requirements of Central Bank of Oman; the risk framework is provided in the Board approved Risk Charter and Credit Policies and Procedures. The policies and procedures are periodically reviewed to ensure alignment to the current best practices.

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

Credit exposures are approved by delegated authorities based on the delegation by the Board and Board Risk Committee. The delegation of authorities is based on the size of the single obligor exposure, the credit quality (internal, external rating) as well as level of credit risk mitigation (collateral, guarantees, etc.) for the proposed exposures. For retail exposures, there is delegation of authority for handling exceptions to approved program lending. Control, monitoring and management of credit exposures and remedial management are done in coordination with respective Business Units as per established procedures. The risk management framework also includes policies with respect to problem recognition, early warning lists, watch lists, classification parameters and risk rating adjustments. The bank is contemplating an early warning trigger system based on predefined credit parameters and account behaviour. The Bank also undertakes stress testing of its portfolio and potential credit costs in the event of a downgrade or default by its customers.

#### Corporate credit

Corporate Credit Risk Division is responsible for independent assessment and control of the risks related to all Corporate, Business Banking, Financial Institutions as well as Small and Medium enterprise exposures. The credit risk associated with any corporate financing is assessed based on an analysis of the customer and the industry it operates in. The credit rating acts as a key factor in credit decisions at the time of approval and subsequent credit assessments. The Division reviews and assesses credit risk for proposed exposures prior to facilities being committed to customers by the concerned business units. Renewals and reviews of facilities are subject to the same process. Each proposal is also assessed with respect to established concentration limits for various economic sectors, countries, risk grades, etc. and deviations, if any are highlighted. The Bank follows a risk adjusted return of capital model for benchmarking risk pricing and each credit proposal is also assessed based on internal benchmarks of required risk adjusted returns. The bank has implemented a customised Moody's Risk Analyst model for risk rating corporate borrowers. The bank maintains an accurate and consistent corporate credit rating for all its customers. The Bank has introduced facility risk rating apart from customer credit rating so as to measure the appropriate loss given default associated with each credit.

In addition to formal annual credit risk reviews of each corporate facility, more frequent reviews are also undertaken for watch list accounts, early warning accounts, lower rated customers, public companies and large exposures. Further, the Bank continues to undertake quarterly review of financial institutions and country portfolio including stress tests and review of adverse rating migrations and outlooks in line with best practices and regulatory guidelines. The Bank also undertook a weekly review across all its business segments of early warning accounts, which showed signs of stress, and remedial action prescribed as necessary. The Bank undertook sector review of its exposure to Real estate, Construction, Steel, Healthcare and lending against shares.

A comprehensive review of the Corporate Credit Portfolio is conducted on a quarterly basis and provided to the Senior Management and the Board Risk Committee. Salient areas covered in the review include:

- Exposures downgraded/negatively migrated
- Weighted average credit grade profile
- Portfolio concentration/ performance
- Position of restructured exposures
- Position of past due exposures
- Exposures secured by equity
- Exposures to real estate and leasing sectors
- Syndicated exposures
- New relationships
- Exposures to senior members and non-resident borrowers
- Exposures to countries / financial institutions
- Clean lending and name lending exposures

The Bank introduced prudent control measures for its UAE operations in line with the changing operating environment detailed below

- Revised business focus on Oman-UAE business corridor with emphasis on businesses sponsored by Omani or reputed UAE nationals.
- Enhanced Due diligence and strengthened KYC processes
- Revised Standard Operating Procedures in line with changing business needs.

#### Retail credit

Retail Credit Division manages the credit risk in the retail portfolio. Credit facilities are offered to retail customers primarily based on Product Programs approved by Risk Committee of the Board. The lending criteria for these programs are regularly reviewed and, if required revised, based on an on-going analysis of product performance and portfolio credit quality and perceived risk. Credit facilities outside the Product Programs are individually assessed by the Retail Credit Risk Division and recommended to the delegated authorities.

A review of the Retail Credit Portfolio is conducted on a quarterly basis and provided to the Management Risk Committee, and to the Board Risk Committee.

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

Monthly management reports are also prepared and submitted to the CRO and to the Business Heads. Salient areas covered in the review include:

- Portfolio quality
- Management Summary of Delinquency and NPA trends (which includes product-wise delinquency analysis, vintage analysis, and delinquencies across various credit criteria, etc.)
- Projects undertaken / fulfilled during the quarter.

System enhancements and continuous improvements have been made on all processes that are critical to improve quality of overall retail portfolio. The bank has a lending strategy through the adoption of pre-defined lending criteria and continuous monitoring of the portfolio, and has implemented a Credit application Scoring Module for its salary related loan portfolio to enhance the Retail Credit Risk framework.

**Loan review mechanism**

The bank has an independent Loan Review Mechanism Division (LRM) with a mandate for constantly evaluating the quality of the loan book, and the balance between risk and reward and to bring about qualitative improvements in credit administration. The division evaluates the effectiveness of loan administration, integrity of the credit grading process, assessment of general and specific loan loss provisions, portfolio quality, etc. In addition to the above the LRM team reviews the bank's effectiveness of approved internal controls and procedures to ensure robust and sound practices are being followed by all stake holders. LRM also performs independent ad hoc reviews, investigations and assessments as directed by management on areas of concern relating to the credit approval process and/or the analysis processes within the bank. Significant findings are reported to the CRO, the MRC and potentially to the BRC where warranted.

**Risk mitigation policies**

The bank manages, limits and controls concentrations of credit risk – in particular, with respect to individual counterparties and groups, and industries and countries. The bank structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored and reviewed periodically by the Management Credit Committee and Board Risk Committee.

**Maximum exposure to credit risk**

| Gross maximum exposure 2017 USD'000 | Gross maximum exposure 2018 USD'000 | | Gross maximum exposure 2018 RO '000 | Gross maximum exposure 2017 RO '000 |
|---|---|---|---|---|
| 861,644 | 684,877 | Balances with Central Banks | 258,016 | 331,733 |
| 360,182 | 254,712 | Due from banks and other money market placements(net) | 98,064 | 138,670 |
| 6,893,171 | 7,297,940 | Loans, advances and financing activities for customers (net) | 2,809,707 | 2,653,871 |
| 378,075 | 600,387 | Financial investments | 202,473 | 145,559 |
| 111,906 | 140,614 | Other assets | 54,137 | 43,084 |
| 7,016 | 1,169 | Derivatives | 450 | 2,701 |
| 8,611,994 | 8,979,699 | Total on balance sheet exposure | 3,422,847 | 3,315,618 |
| 947,844 | 958,088 | Guarantees | 368,864 | 364,920 |
| 213,473 | 261,912 | Documentary letters of credit | 100,836 | 82,187 |
| 422,927 | 310,699 | Undrawn commitment | 119,619 | 162,827 |
| 1,584,244 | 1,530,699 | Total off-balance sheet exposure | 589,319 | 609,934 |

The above table represents the maximum credit risk exposure to the bank at 31 December 2018 and 2017 without taking into account the collateral held or other credit enhancements. Management is confident that the bank has suitable policies to measure and control the credit risk. In addition credit risk is mitigated through collaterals in the form of mortgages and guarantees wherever required.





## 30 Risk management (continued)

### 30.1 Credit risk (continued)

An ageing analysis of the Bank's loans which are past due but not impaired is set out below:

| | Loans in arrears 1-30 days RO'000 | Loans in arrears 31-60 days RO'000 | Loans in arrears 61-89 days RO'000 | Total RO'000 |
|---|---|---|---|---|
| Loans and advances to customers at | | | | |
| 31 December 2018 | 60,692 | 31,600 | 23,810 | 116,102 |
| 31 December 2018 – USD'000s | 157,642 | 82,078 | 61,844 | 301,564 |
| 31 December 2017 | 36,853 | 55,612 | 40,415 | 132,880 |
| 31 December 2017 – USD'000s | 95,722 | 144,447 | 104,974 | 345,143 |

**Collateral and other credit enhancements**

The Bank employs a range of policies and practices to mitigate credit risk. The most traditional of these is the taking of security for funds advanced, which is the common practice. The bank implements guidelines on the acceptability of specific classes of collateral or credit risk mitigation. The principal collateral types for loans and advances are:

- Charges over business assets such as premises, inventory and accounts receivable
- Lien on fixed deposits
- Cash margins
- Mortgages over residential and commercial properties
- Pledge of marketable shares and securities

The housing loans are secured by mortgage over the residential property.

The Management monitors the market value of collateral, requests additional collateral in accordance with the underlying agreement, and monitors the market value of collateral obtained during its review of the adequacy of the allowance for impairment losses.

It is the Bank's policy to dispose of repossessed properties in an orderly fashion. The proceeds are used to reduce or repay the outstanding claim. In general, the bank does not occupy repossessed properties for business use.

An analysis of the collateral held and other credit enhancement held against loan and advances granted is as follows:

| | 12-Month ECL RO'000 | Lifetime ECL not credit -impaired RO'000 | Lifetime ECL credit -impaired RO'000 | Total RO'000 |
|---|---|---|---|---|
| Collateral available | 1,258,105 | 153,367 | 54,717 | 1,466,189 |
| Government soft loans* | 1,429 | - | 1,253 | 2,682 |
| Balance as at 31 December 2018 | 1,259,534 | 153,367 | 55,970 | 1,468,871 |
| Balance as at 31 December 2018 – USD'000s | 3,271,517 | 398,356 | 145,377 | 3,815,250 |
| Balance as at 31 December 2017 | 1,329,957 | 96,566 | 21,253 | 1,447,776 |
| Balance as at 31 December 2017 – USD'000s | 3,454,434 | 250,821 | 55,203 | 3,760,458 |

** Government Soft Loans are guaranteed by the Government to the extent of the outstanding principal.*

The amount of total secured loans and advances is less than the total value of collateral as stated above.

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

The following table sets out information about the credit quality of financial assets measured at amortised cost. Unless specifically indicated, for financial assets, the amounts in the table represent gross carrying amounts.

| | 12-Month ECL RO'000 | Lifetime ECL not credit -impaired RO'000 | Lifetime ECL credit -impaired RO'000 | Total RO'000 |
|---|---|---|---|---|
| **Loans and advances to customers–corporate banking** | | | | |
| Performing loans (Grades 1-5) | 764,860 | 309,420 | - | 1,074,280 |
| Performing loans (Grades 6) | 204,274 | 41,172 | - | 245,446 |
| Performing loans (Grades 7) | - | 111,110 | - | 111,110 |
| Non-performing loans (Grades 8-10) | - | - | 107,359 | 107,359 |
| **Gross loans and advances to customers–corporate banking** | **969,134** | **461,702** | **107,359** | **1,538,195** |
| **Loss allowance-carrying amount** | **4,830** | **17,724** | **74,707** | **97,261** |
| **Loans and advances to customers – retail banking** | | | | |
| Performing loans (Grades 1-7) | 1,305,993 | 62,737 | - | 1,368,730 |
| Non-performing loans (Grades 8-10) | - | - | 33,160 | 33,160 |
| **Gross loans and advances to customers – retail banking** | **1,305,993** | **62,737** | **33,160** | **1,401,890** |
| **Loss allowance-carrying amount** | **9,712** | **8,132** | **15,272** | **33,116** |
| **Total gross loans and advances to customers** | **2,275,127** | **524,439** | **140,519** | **2,940,085** |
| **Credit related contingent items** | | | | |
| Performing loans (Grades 1-5) | 245,325 | 95,839 | - | 341,164 |
| Performing loans (Grades 6) | 22,336 | 40,971 | - | 63,307 |
| Performing loans (Grades 7) | - | 22,581 | - | 22,581 |
| Non-performing loans (Grades 8-10) | - | - | 1,572 | 1,572 |
| **Total gross loans and advances to customers** | **267,661** | **159,391** | **1,572** | **428,624** |
| **Loss allowance-carrying amount** | **1,433** | **7,791** | **-** | **9,224** |
| Performing banks (Aa1 to Baa3) | 71,158 | - | - | 71,158 |
| Performing banks (B1 to Ba2) | 13,288 | - | - | 13,288 |
| Performing banks (Unrated) | 13,996 | - | - | 13,996 |
| **Due from banks and money market placements** | **98,443** | **-** | **-** | **98,443** |
| **Loss allowance-carrying amount** | **379** | **-** | **-** | **379** |
| **Investment securities** | **198,765** | **-** | **-** | **198,765** |
| **Loss allowance-carrying amount** | **591** | **-** | **-** | **591** |



## 30 Risk management (continued)

### 30.1 Credit risk (continued)

| | 12-Month ECL USD'000 | Lifetime ECL not credit -impaired USD'000 | Lifetime ECL credit -impaired USD'000 | Total USD'000 |
|---|---|---|---|---|
| **Loans and advances to customers–corporate banking** | | | | |
| Performing loans (Grades 1-5) | 1,986,649 | 803,688 | - | 2,790,337 |
| Performing loans (Grades 6) | 530,582 | 106,940 | - | 637,522 |
| Performing loans (Grades 7) | - | 288,597 | - | 288,597 |
| Non-performing loans (Grades 8-10) | - | - | 278,855 | 278,855 |
| **Gross loans and advances to customers–corporate banking** | **2,517,231** | **1,199,225** | **278,855** | **3,995,311** |
| **Loss allowance-carrying amount** | **12,545** | **46,036** | **194,044** | **252,625** |
| **Loans and advances to customers – retail banking** | | | | |
| Performing loans (Grades 1-7) | 3,392,189 | 162,953 | - | 3,555,142 |
| Non-performing loans (Grades 8-10) | - | - | 86,129 | 86,129 |
| **Gross loans and advances to customers–retail banking** | **3,392,189** | **162,953** | **86,129** | **3,641,271** |
| **Loss allowance-carrying amount** | **25,226** | **21,122** | **39,668** | **86,016** |
| **Total gross loans and advances to customers** | **5,909,420** | **1,362,178** | **364,984** | **7,636,582** |
| **Credit related contingent items** | | | | |
| Performing loans (Grades 1-5) | 637,208 | 248,932 | - | 886,140 |
| Performing loans (Grades 6) | 58,016 | 106,418 | - | 164,434 |
| Performing loans (Grades 7) | - | 58,652 | - | 58,652 |
| Non-performing loans (Grades 8-10) | - | - | 4,083 | 4,083 |
| **Total gross loans and advances to customers** | **695,224** | **414,002** | **4,083** | **1,113,309** |
| **Loss allowance-carrying amount** | **3,722** | **20,236** | **-** | **23,958** |
| Performing banks (Aa1 to Baa3) | 184,828 | - | - | 184,828 |
| Performing banks (B1 to Ba2) | 34,515 | - | - | 34,515 |
| Performing banks (Unrated) | 36,353 | - | - | 36,353 |
| **Due from banks and money market placements** | **255,696** | **-** | **-** | **255,696** |
| **Loss allowance-carrying amount** | **984** | **-** | **-** | **984** |
| **Investment securities** | **516,273** | **-** | **-** | **516,273** |
| **Loss allowance-carrying amount** | **1,535** | **-** | **-** | **1,535** |

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

**Impairment assessment (Policy applicable from 1 January 2018)**

### Definition of default and cure

The Bank considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Bank considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Bank also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate.
Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Bank
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the loan is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Bank
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection • Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties

It is the Bank's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

### Incorporation of forward-looking information

The bank incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. Based on consideration of a variety of external actual and forecast information, the bank formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

Given the nature of the Bank's exposures and availability of historical statistically reliable information, the bank derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Moody's for each rating category.

### Economic variable assumptions

The method applied for determination of macroeconomic scenarios and their probabilities is a hybrid approach that combines deterministic forecast / modelling with analysis of stochastic distribution to get the alternative economic conditions and their probabilities.

The major assumptions and methodological choices can be summarised in a following set of steps:

1. Despite the fact that oil price was not chosen as an explanatory variable during statistical optimisation of variable selection, the business acumen as well as correlation analysis suggest that it is a major driving force in determination of GDP and real interest rate as defined by the World Bank (GDP deflator is highly affected by oil price as oil manufacturing is responsible for a vast portion of GDP volume in Oman)
2. The base scenario was created on the assumption of stabilisation of oil price at the level of 54 USD/barrel for Brent oil.
3. The alternative scenarios were constructed based on deviations from the base trajectory of oil price taking into account:

a. historical volatility of changes in oil prices (28% standard deviation of annual relative price changes),
b. size of the detachment equal to plus/minus 0,87 standard deviation from the base scenario as an approximate representation of 33,33% probability of alternative (adverse and favourable) scenarios,

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

**Impairment assessment (Policy applicable from 1 January 2018) (continued)**

c. the time dynamics of the variable was based on assumption of normal distribution of annual changes of oil prices with some mean reverting characteristics and respective time scaling (standard deviation times square root of time) with the signs (-/+) in line with the character of the scenario (adverse / favourable).

4. GDP and real interest rate were forecasted deterministically based on their reciprocal dependencies and their relationship (with appropriate time lags) to oil price changes assuming mid-prices of Brent oil under given scenario as obtained through the process described in 3.
5. GDP per capita was predicted through regression to corresponding GDP changes as estimated for a given scenario and assumed lowering pace of population growth not dependent on the scenario in question.

| Key drivers | ECL scenario and assigned weightage | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Real Interest Rate | Base scenario | 7.6% | 7.6% | 7.6% | 7.6% |
| | Upside scenario | 3.7% | 5.5% | 6.3% | 6.8% |
| | Downside scenario | 13.9% | 11.8% | 10.4% | 9.4% |
| GDP | Base scenario | 5.1% | 4.3% | 4.3% | 4.3% |
| | Upside scenario | 6.8% | 7.2% | 6.7% | 6.7% |
| | Downside scenario | 3.3% | 1.4% | 1.7% | 1.7% |
| GDP per capita | Base scenario | 0.1% | -0.3% | 0.2% | 0.7% |
| | Upside scenario | 2.3% | 3.2% | 3.2% | 3.7% |
| | Downside scenario | -2.0% | -3.7% | -2.9% | -2.3% |

The following table shows a comparison of the Bank's allowances for credit losses on non-impaired financial assets (Stages 1 and 2) under IFRS 9 as at December 31, 2018 based on the probability weightings of three scenarios with allowances for credit losses resulting from simulations of each scenario weighted at 100%.

| Sensitivity of impairment estimates | ECL | Impact on ECL |
|---|---|---|
| ECL on non-impaired loans under IFRS9 | 50,591.28 | |
| Upside scenario | 44,805.78 | 5,785.50 |
| Base scenario | 50,244.41 | 346.87 |
| Downside scenario | 56,723.64 | -6,132.36 |

For computation of ECL, the Bank considers three scenario viz. base case, upside case and downside case with weightage of 33.33% each.

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.1 Credit risk (continued)

**Impairment assessment (Policy applicable from 1 January 2018) (continued)**

Treasury, trading and interbank relationships

The Bank's treasury, trading and interbank relationships and counterparties comprise financial services institutions, banks, broker-dealers, exchanges and clearing-houses. For these relationships, the Bank's credit risk department analyses publicly available information such as financial information and other external data and assigns the internal rating.

Corporate and small business lending

For corporate and investment banking loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.
- The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and retail mortgages

Consumer lending comprises unsecured personal loans, credit cards and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing

**Sensitivity analysis**

The most significant assumptions affecting the ECL allowance are as follows:

- Interest rate, given its impact on companies' likelihood of default; and
- GDP, given the significant impact on companies' performance and collateral valuations;
- Unemployment rate, given its impact on secured and unsecured borrowers' ability to meet their contractual repayments.

**Exposure at default**

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 loan, the Bank assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 loan that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Bank determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Bank's models.

**Loss given default**

For corporate and investment banking financial instruments, LGD values are assessed at least every twelve months by account managers and reviewed and approved by the Bank's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Bank segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider



30 Risk management (continued)
30.1 Credit risk (continued)
Impairment assessment (Policy applicable from 1 January 2018) (continued)

**Loss given default (continued)**

set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics. Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the bank.

The Bank estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI IFRS 9 segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

**Significant Increase in Credit Risk**

The Bank continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Bank assesses whether there has been a significant increase in credit risk since initial recognition.

The Bank also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. In certain cases, the Bank may also consider that events set out below are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

a. Inadequate or unreliable financial or other information such as unavailability of audited financial statements within 120 days from end of accounting period.

b. Delay in documentation execution over 35 days from limit set up due to disputes with customers.

c. Borrower is subject to litigation by third parties that may have a significant impact on his financial position.

d. Frequent changes in key senior management personnel without acceptable successors or professional management.

e. Intra Group transfer of funds without underlying transactions beyond 50% of Tangible Net Worth.

f. Deferment/delay in the date for commencement of commercial operations by more than one year except in Government projects or delays are due to Government approvals.

g. Modifications of terms resulting in concessions granted to the borrower (after examining the cash flows of the borrower/financial position/ ability to repay) including extension of moratorium, deferment of payment, waiver of covenants etc. This requirement shall be in conformity to the restructuring guidelines issued by CBO from time to time.

h. A fall of 25% or more in the turnover or in the EBIT as compared to the previous year except in the case of change in business model/one of material events.

i. A fall in Debt Service coverage ratio to below 1 except in cases which have acceptable external credit support.

j. Rating downgrade by 3 notches for ratings from R1 to R4 and 2 notches downgrade for R5 and R6.

k. Erosion in net worth by more than 20% compared to previous year coupled with increase in leverage by 1.5 times.

**Model risk management:**

The Bank has utilised models in many of its financial and business activities from underwriting a credit facility to reporting expected loss under the IFRS9 accounting standards.

To manage the model risks, the Bank has implemented the IFRS 9 Governance Framework (the Framework). The Framework is a bank wide policy and is applicable to all models of the Bank. According to the Framework, all internally or externally (vendor based) developed risk quantification models that directly affect the financial reporting on Expected Loss (EL) and Lifetime Expected Loss (LEL) require independent validation.

The Framework establishes a systematic approach to manage the development, validation, approval, implementation and on-going use of the models. It sets out an effective management structure with clearly defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international practices. Any major change to the Framework must be approved by the Board of Directors or the BRC.

The Bank has a practice of doing independent model validation which provides recommendation to approve the use of the new risk quantification / valuation models. In addition to new model validation, it also evaluates the performance of existing models through an annual validation process. The independency of the team will serve as an effective second line of defense for the Bank in terms of usage of models.

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.2 Liquidity risk

Liquidity risk is the risk that the Bank will be unable to meet its payment obligations when they fall due under normal and stressed circumstances. To limit this risk, the management continuously looks for opportunities to diversify its 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 grade collateral which could be used to secure additional funding if required.

The Bank maintains liquidity by continually assessing, identifying and monitoring changes in funding needs required to meet strategic goals set in terms of the overall strategy. In addition the Bank holds certain liquid assets as part of its liquidity risk management strategy.

The Bank manages the liquidity risk based on the Central Bank of Oman guidelines and the Liquidity and Liquidity Contingency Policies, which are approved and periodically reviewed by the Board Risk Committee.

Liquidity Risk position is monitored regularly through analysis of various reports, such as, Maturity of Assets and Liabilities, Liquidity Lines, Early Warning Indicators and Stock Ratios. Further, the bank also periodically conducts stress tests on liquidity based on market and bank specific events in line with Basel Committee recommendations. The liquidity position of the bank and stress test scenarios are regularly reviewed by the management and also discussed at the Board Risk Committee.

The Central Bank of Oman has issued guidelines on the implementation of Basel III liquidity framework which are Liquidity Coverage Ratio (LCR) and Net Stable Funding (NSFR).

The Net Stable Funding Ratio (NSFR) is a longer term structural ratio designed to address liquidity mismatches and reduce funding risk over a one year horizon. It is effective January 2019, with a minimum ratio of 100% as per the regulatory guidance.

The residual maturity profile of the assets, liabilities and equity at **31 December 2018** is as follows:

| | On demand within 3 months RO'000 | 3 to 12 months RO'000 | Subtotal less than 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Subtotal over 12 months RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | 250,988 | 29,343 | 280,331 | 17,879 | 16,845 | 34,724 | 315,055 |
| Due from banks and other money market placements (net) | 78,237 | 10,202 | 88,439 | - | 9,625 | 9,625 | 98,064 |
| Loans, advances and financing activities for customers (net) | 439,718 | 234,739 | 674,457 | 639,487 | 1,495,763 | 2,135,250 | 2,809,707 |
| Financial investments | 112,470 | 2,030 | 114,500 | 33,569 | 83,080 | 116,649 | 231,149 |
| Premises and equipment | - | - | - | - | 64,360 | 64,360 | 64,360 |
| Other assets | 47,308 | 6,909 | 54,217 | 370 | - | 370 | 54,587 |
| **Total assets** | **928,721** | **283,223** | **1,211,944** | **691,305** | **1,669,673** | **2,360,978** | **3,572,922** |
| Due to banks and other money market deposits | 132,849 | 15,400 | 148,249 | 7,700 | - | 7,700 | 155,949 |
| Customers' deposits and unrestricted investment accounts | 596,509 | 839,117 | 1,435,626 | 546,048 | 470,708 | 1,016,756 | 2,452,382 |
| Euro medium term notes | - | 114,648 | 114,648 | 192,500 | - | 192,500 | 307,148 |
| Other liabilities | 85,841 | 5,069 | 90,910 | 2,622 | 2 | 2,624 | 93,534 |
| Taxation | 10,419 | - | 10,419 | - | - | - | 10,419 |
| Subordinated debt | 17,000 | – | 17,000 | - | - | - | 17,000 |
| Shareholders' equity | - | - | - | - | 420,990 | 420,990 | 420,990 |
| Tier 1 perpetual bonds | - | - | - | - | 115,500 | 115,500 | 115,500 |
| **Total liabilities and shareholders' equity** | **842,618** | **974,234** | **1,816,852** | **748,870** | **1,007,200** | **1,756,070** | **3,572,922** |



## 30 Risk management (continued)

### 30.2 Liquidity risk (continued)

| | On demand within 3 months USD'000 | 3 to 12 months USD'000 | Subtotal less than 12 months USD'000 | 1 to 5 years USD'000 | Over 5 years USD'000 | Subtotal over 12 months USD'000 | Total USD'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | 651,917 | 76,216 | 728,133 | 46,439 | 43,753 | 90,192 | 818,325 |
| Due from banks and other money market placements (net) | 203,213 | 26,499 | 229,712 | - | 25,000 | 25,000 | 254,712 |
| Loans, advances and financing activities for customers (net) | 1,142,125 | 609,712 | 1,751,837 | 1,661,005 | 3,885,098 | 5,546,103 | 7,297,940 |
| Financial investments | 292,130 | 5,273 | 297,403 | 87,192 | 215,792 | 302,984 | 600,387 |
| Premises and equipment | - | - | - | - | 167,169 | 167,169 | 167,169 |
| Other assets | 122,877 | 17,945 | 140,822 | 961 | - | 961 | 141,783 |
| **Total assets** | **2,412,262** | **735,645** | **3,147,907** | **1,795,597** | **4,336,812** | **6,132,409** | **9,280,316** |
| Due to banks and other money market deposits | 345,062 | 40,000 | 385,062 | 20,000 | - | 20,000 | 405,062 |
| Customers' deposits and unrestricted investment accounts | 1,549,374 | 2,179,525 | 3,728,899 | 1,418,306 | 1,222,618 | 2,640,924 | 6,369,823 |
| Euro medium term notes | - | 297,787 | 297,787 | 500,000 | - | 500,000 | 797,787 |
| Other liabilities | 222,964 | 13,166 | 236,130 | 6,810 | 5 | 6,815 | 242,945 |
| Taxation | 27,062 | - | 27,062 | - | - | - | 27,062 |
| Subordinated debt | 44,156 | - | 44,156 | - | - | - | 44,156 |
| Shareholders' equity | - | - | - | - | 1,093,481 | 1,093,481 | 1,093,481 |
| Tier 1 perpetual bonds | - | - | - | - | 300,000 | 300,000 | 300,000 |
| **Total liabilities and shareholders' equity** | **2,188,618** | **2,530,478** | **4,719,096** | **1,945,116** | **2,616,104** | **4,561,220** | **9,280,316** |

## 30 Risk management (continued)

### 30.2 Liquidity risk (continued)

The maturity profile of the assets, liabilities and equity at 31 December 2017 is as follows:

| | On demand within 3 months RO'000 | 3 to 12 months RO'000 | Subtotal less than 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Subtotal over 12 months RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | 323,582 | 25,475 | 349,057 | 17,907 | 16,147 | 34,054 | 383,111 |
| Due from banks and other money market placements (net) | 107,331 | 20,174 | 127,505 | 1,540 | 9,625 | 11,165 | 138,670 |
| Loans, advances and financing activities for customers (net) | 366,100 | 295,458 | 661,558 | 628,930 | 1,363,383 | 1,992,313 | 2,653,871 |
| Financial investments | 95,070 | 1,972 | 97,042 | 16,065 | 70,013 | 86,078 | 183,120 |
| Premises and equipment | - | - | - | - | 65,795 | 65,795 | 65,795 |
| Other assets | 40,372 | 4,554 | 44,926 | 859 | - | 859 | 45,785 |
| **Total assets** | **932,455** | **347,633** | **1,280,088** | **665,301** | **1,524,963** | **2,190,264** | **3,470,352** |
| Due to banks and other money market deposits | 83,379 | 3,878 | 87,257 | 38,500 | - | 38,500 | 125,757 |
| Customers' deposits and unrestricted investment accounts | 694,205 | 766,791 | 1,460,996 | 540,763 | 459,508 | 1,000,271 | 2,461,267 |
| Euro medium term notes | - | - | - | 230,906 | - | 230,906 | 230,906 |
| Other liabilities | 68,657 | 3,782 | 72,439 | 908 | - | 908 | 73,347 |
| Taxation | 7,816 | - | 7,816 | - | - | - | 7,816 |
| Subordinated debt | - | 7,000 | 7,000 | 18,000 | - | 18,000 | 25,000 |
| Shareholders' equity | - | - | - | - | 430,759 | 430,759 | 430,759 |
| Tier 1 perpetual bonds | - | - | - | - | 115,500 | 115,500 | 115,500 |
| **Total liabilities and shareholders' equity** | **854,057** | **781,451** | **1,635,508** | **829,077** | **1,005,767** | **1,834,844** | **3,470,352** |

The maturity profile of the assets, liabilities and equity at 31 December 2017 is as follows:

| | On demand within 3 months USD'000 | 3 to 12 months USD'000 | Subtotal less than 12 months USD'000 | 1 to 5 years USD'000 | Over 5 years USD'000 | Subtotal over 12 months USD'000 | Total USD'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | 840,473 | 66,169 | 906,642 | 46,512 | 41,940 | 88,452 | 995,094 |
| Due from banks and other money market placements (net) | 278,782 | 52,400 | 331,182 | 4,000 | 25,000 | 29,000 | 360,182 |
| Loans, advances and financing activities for customers (net) | 950,909 | 767,423 | 1,718,332 | 1,633,584 | 3,541,255 | 5,174,839 | 6,893,171 |
| Financial investments | 246,935 | 5,122 | 252,057 | 41,727 | 181,852 | 223,579 | 475,636 |
| Premises and equipment | - | - | - | - | 170,896 | 170,896 | 170,896 |
| Other assets | 104,862 | 11,829 | 116,691 | 2,231 | - | 2,231 | 118,922 |
| **Total assets** | **2,421,961** | **902,943** | **3,324,904** | **1,728,054** | **3,960,943** | **5,688,997** | **9,013,901** |
| Due to banks and other money market deposits | 216,569 | 10,073 | 226,642 | 100,000 | - | 100,000 | 326,642 |
| Customers' deposits and unrestricted investment accounts | 1,803,130 | 1,991,665 | 3,794,795 | 1,404,579 | 1,193,527 | 2,598,106 | 6,392,901 |
| Euro medium term notes | - | - | - | 599,756 | - | 599,756 | 599,756 |
| Other liabilities | 178,331 | 9,823 | 188,154 | 2,358 | - | 2,358 | 190,512 |
| Taxation | 20,301 | - | 20,301 | - | - | - | 20,301 |
| Subordinated debt | - | 18,182 | 18,182 | 46,753 | - | 46,753 | 64,935 |
| Shareholders' equity | - | - | - | - | 1,118,854 | 1,118,854 | 1,118,854 |
| Tier 1 perpetual bonds | - | - | - | - | 300,000 | 300,000 | 300,000 |
| **Total liabilities and shareholders' equity** | **2,218,331** | **2,029,743** | **4,248,074** | **2,153,446** | **2,612,381** | **4,765,827** | **9,013,901** |



Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.2 Liquidity risk (continued)

**Liquidity coverage ratio**

The Liquidity coverage ratio (LCR) is a short time ratio designed to increase resilience against a liquidity shortage of up to 30 days. The LCR is computed as per CBO requirement under the circular BM1127 (BASEL III: Framework on Liquidity coverage ratio and LCR disclosure standards). It is applicable from January 1, 2015 with a minimum ratio of 60% and increasing by 10% every year thereafter till it reaches a minimum required level of 100% on 1 January, 2019.

| Total Unweighted Value (average) USD'000 | Total Weighted Value (average) USD'000 | | Total Unweighted Value RO'000 | Total Weighted Value (average) RO'000 |
|---|---|---|---|---|
| - | 1,230,668 | High Quality Liquid Assets | - | 473,807 |
| - | 1,230,668 | **Total High Quality Liquid Assets (HQLA)** | - | 473,807 |
| | | **Cash outflows** | | |
| 1,822,522 | 105,890 | Retail deposits and deposits from small business customers of which: | 701,671 | 40,768 |
| 1,527,190 | 76,358 | Stable deposits | 587,968 | 29,398 |
| 295,332 | 29,532 | Less stable deposits | 113,703 | 11,370 |
| 2,366,878 | 852,145 | Unsecured wholesale funding, of which: Operational deposits (all counterparties) and deposits in networks of cooperative banks | 911,248 | 328,076 |
| 52,673 | 5,268 | Additional requirements, of which Credit and liquidity facilities | 20,279 | 2,028 |
| 1,275,314 | 72,138 | Other contingent funding obligations | 490,996 | 27,773 |
| - | 1,035,442 | **Total cash outflows** | - | 398,645 |
| | | **Cash Inflows** | | |
| 787,616 | 540,452 | Inflows from fully performing exposures | 303,232 | 208,074 |
| 25,631 | 25,631 | Other cash inflows | 9,868 | 9,868 |
| 813,247 | 566,083 | **Total cash inflows** | 313,100 | 217,942 |
| - | 1,230,668 | **Total high quality liquid assets** | - | 473,807 |
| - | 469,358 | **Total net cash outflows** | - | 180,703 |
| - | 262.20 | **Liquidity coverage ratio (%)** | - | 262.20 |

### 30.3 Market risk

The Bank is exposed to market risk, which is the risk that the fair value of the financial assets held by the Bank will fluctuate due to changes in market prices. Market risk arises from changes in the fair value of open positions held in foreign exchange, interest rate, currency, equity, credit spreads, etc. Market risk is managed based on the Central Bank of Oman guidelines and the Market Risk Policy, which is approved and periodically reviewed by the Board Risk Committee. Stress tests are also conducted periodically incorporating adverse movements in equity value, foreign exchange, etc. and reviewed by the Management and Board Risk Committee.

The Bank offers hedging products to its customers to hedge their genuine exposures, related to interest rate risk, foreign exchange risk and commodity risk. The counterparty credit risk exposures for such transactions (interest rate swaps, commodities contracts, currency forwards and options, etc.) are assessed based on the positive marked-to-market values of the contracts and the potential future exposures. The Bank has adopted risk weightings in line with best practices to capture the credit risk related to these off-balance sheet exposures.

- **Equity risk**
  The proprietary equity positions are held in the 'Available-for-Sale' category. The market risk is monitored though daily mark-to-market reports

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.3 Market risk (continued)

which are circulated to the management and, if any, required actions are promptly taken. The portfolio is also monitored and managed as per the Investment Policy approved by the Board Risk Committee.

- **Interest rate risk**
  The principal market risk to which non-trading portfolio is exposed is the risk of loss from fluctuation in the future cash flows or fair values of financial instruments because of changes in market interest rates.

Interest rate risk arises from the possibility that changes in interest rates will affect future profitability or the fair values of financial instruments. The Bank is exposed to interest rate risk as a result of mismatches of interest rate re-pricing of assets and liabilities.

Methods and assumptions used in preparing the sensitivity analysis: The methods for interest rate sensitivity analysis are Maturity Gap Analysis (which measures the interest rate sensitivity of earnings) and Duration (which measures the interest rate sensitivity of capital). These are in line with the BIS in its paper on 'Principles for the Management and Supervision of Interest Rate Risk' issued in July 2004.

Interest rate risk is managed by monitoring the sensitivity of the Bank's financial assets and liabilities to various standardized interest rate shocks. Standardised shocks include a 100 basis point and 200 basis point parallel shifts in yield curves that are considered on a monthly basis. The impact of these shocks is analysed in the context of its impact on Earnings and Economic Value. The impact is compared against internal limits which have been formulated in line with the Central Bank of Oman and Basel Committee guidelines. The analysis is regularly reviewed by the Management and Board Risk Committee.

Earning impact of 200 basis points parallel shift in interest rate is provided below:

| As at December 2018 | 200 bps increase | 200 bps decrease |
|---|---|---|
| Earnings impact–RO'000s | **8,121** | **(8,121)** |
| Earnings impact–USD'000s | **21,094** | **(21,094)** |

In addition, stress scenarios based on specific events or market disruptions are also analysed and presented at monthly ALCO meetings to estimate the impact on liquidity and earnings.

The Bank has been consistently using the above methods/assumptions to conduct interest rate sensitivity analysis. The above sensitivity analyses are carried out at monthly rests and results thereof monitored against the in-house limits and the results are also actively deliberated at the ALCO meetings and presented to the Board Risk Committee.

There have not been any significant changes in Interest Rate Risk management process in the Bank during the year.

## 30 Risk management (continued)

### 30.3 Market risk (continued)

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2018 is as follows:

| | Average effective interest rate | On demand within 3 months RO'000 | 3 to 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Non-interest RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | N/A | - | - | - | - | 315,055 | 315,055 |
| Due from banks and other money market placements (net) | 2.93% | 51,732 | 18,287 | - | - | 28,045 | 98,064 |
| Loans, advances and financing activities for customers (net) | 5.50% | 913,367 | 634,858 | 644,981 | 614,141 | 2,360 | 2,809,707 |
| Financial investments | 4.50% | 25,961 | - | 71,727 | 105,173 | 28,288 | 231,149 |
| Premises and equipment | N/A | - | - | - | - | 64,360 | 64,360 |
| Other assets | N/A | - | - | - | - | 54,587 | 54,587 |
| **Total assets** | | **991,060** | **653,145** | **716,708** | **719,314** | **492,695** | **3,572,922** |
| Due to banks and other money market deposits | 8.34% | 146,536 | 3,850 | - | - | 5,563 | 155,949 |
| Customers' deposits and unrestricted investment accounts | 1.84% | 206,036 | 1,185,145 | 277,510 | 4,000 | 779,691 | 2,452,382 |
| Euro medium term notes | 4.30% | - | - | 307,148 | - | - | 307,148 |
| Other liabilities | N/A | 1,109 | - | - | - | 92,425 | 93,534 |
| Taxation | N/A | - | - | - | - | 10,419 | 10,419 |
| Tier 1 Perpetual Bond | 7.88% | - | - | 115,500 | - | - | 115,500 |
| Subordinated debt | 4.94% | - | 17,000 | - | - | - | 17,000 |
| Shareholders' equity | N/A | - | - | - | - | 420,990 | 420,990 |
| **Total liabilities and shareholders' equity** | | **353,681** | **1,205,995** | **700,158** | **4,000** | **1,309,088** | **3,572,922** |
| **Total interest rate sensitivity gap** | | **637,379** | **(552,850)** | **16,550** | **715,314** | **(816,393)** | **-** |
| **Cumulative interest rate sensitivity gap** | | **637,379** | **84,529** | **101,079** | **816,393** | **-** | **-** |

## 30 Risk management (continued)

### 30.3 Market risk (continued)

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2018 is as follows:

| | Average effective interest rate | On demand within 3 months USD'000 | 3 to 12 months USD'000 | 1 to 5 years USD'000 | Over 5 years USD'000 | Non-interest USD'000 | Total USD'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | N/A | - | - | - | - | 818,325 | 818,325 |
| Due from banks and other money market placements (net) | 2.93% | 134,369 | 47,499 | - | - | 72,844 | 254,712 |
| Loans, advances and financing activities for customers (net) | 5.50% | 2,372,382 | 1,648,982 | 1,675,275 | 1,595,171 | 6,130 | 7,297,940 |
| Financial investments | 4.50% | 67,431 | - | 186,304 | 273,177 | 73,475 | 600,387 |
| Premises and equipment | N/A | - | - | - | - | 167,169 | 167,169 |
| Other assets | N/A | - | - | - | - | 141,783 | 141,783 |
| **Total assets** | | **2,574,182** | **1,696,481** | **1,861,579** | **1,868,348** | **1,279,726** | **9,280,316** |
| Due to banks and other money market deposits | | 380,613 | 10,000 | - | - | 14,449 | 405,062 |
| Customers' deposits and unrestricted investment accounts | 8.34% | 535,158 | 3,078,299 | 720,805 | 10,390 | 2,025,171 | 6,369,823 |
| Euro medium term notes | 1.84% | - | - | 797,787 | - | - | 797,787 |
| Other liabilities | 4.30% | 2,881 | - | - | - | 240,064 | 242,945 |
| Taxation | N/A | - | - | - | - | 27,062 | 27,062 |
| Tier 1 Perpetual Bond | N/A | - | - | 300,000 | - | - | 300,000 |
| Subordinated debt | 7.88% | - | 44,156 | - | - | - | 44,156 |
| Shareholders' equity | 4.94% | - | - | - | - | 1,093,481 | 1,093,481 |
| **Total liabilities and shareholders' equity** | | **918,652** | **3,132,455** | **1,818,592** | **10,390** | **3,400,227** | **9,280,316** |
| **Total interest rate sensitivity gap** | | **1,655,530** | **(1,435,974)** | **42,987** | **1,857,958** | **(2,120,502)** | **-** |
| **Cumulative interest rate sensitivity gap** | | **1,655,530** | **219,556** | **262,543** | **2,120,501** | **-** | |



Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.3 Market risk (continued)

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2017 is as follows:

| | Average effective interest rate | On demand within 3 months RO'000 | 3 to 12 months RO'000 | 1 to 5 years RO'000 | Over 5 years RO'000 | Non-interest RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | N/A | - | - | - | - | 383,111 | 383,111 |
| Due from banks and other money market placements (net) | 2.37% | 74,081 | 22,099 | - | - | 42,490 | 138,670 |
| Loans, advances and financing activities for customers (net) | 5.36% | 859,385 | 600,778 | 664,225 | 529,483 | - | 2,653,871 |
| Financial investments | 3.45% | 8,955 | 7,510 | 54,344 | 74,247 | 38,064 | 183,120 |
| Premises and equipment | N/A | - | - | - | - | 65,795 | 65,795 |
| Other assets | N/A | - | - | - | - | 45,785 | 45,785 |
| **Total assets** | | **942,421** | **630,387** | **718,569** | **603,730** | **575,245** | **3,470,352** |
| Due to banks and other money market deposits | 5.22% | 118,390 | 3,878 | - | - | 3,489 | 125,757 |
| Customers' deposits and unrestricted investment accounts | 1.64% | 315,216 | 1,100,687 | 273,338 | - | 772,026 | 2,461,267 |
| Euro medium term notes | 3.02% | - | - | 230,906 | - | - | 230,906 |
| Other liabilities | N/A | 1,782 | - | - | - | 71,565 | 73,347 |
| Taxation | N/A | - | - | - | - | 7,816 | 7,816 |
| Tier 1 Perpetual Bond | 7.88% | - | - | 115,500 | - | - | 115,500 |
| Subordinated debt | 5.09% | - | 7,000 | 18,000 | - | - | 25,000 |
| Shareholders' equity | N/A | - | - | - | - | 430,759 | 430,759 |
| **Total liabilities and shareholders' equity** | | **435,388** | **1,111,565** | **637,744** | **-** | **1,285,655** | **3,470,352** |
| **Total interest rate sensitivity gap** | | **507,033** | **(481,178)** | **80,825** | **603,730** | **(710,410)** | **-** |
| **Cumulative interest rate sensitivity gap** | | **507,033** | **25,855** | **106,680** | **710,410** | **-** | **-** |

Notes to the Financial Statements
As at 31 December 2018

## 30 Risk management (continued)

### 30.3 Market risk (continued)

The Bank's interest sensitivity position based on contractual re-pricing arrangements at 31 December 2017 is as follows:

| | Average effective interest rate | On demand within 3 months USD'000 | 3 to 12 months USD'000 | 1 to 5 years USD'000 | Over 5 years USD'000 | Non-interest USD'000 | Total USD'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks | N/A | - | - | - | - | 995,094 | 995,094 |
| Due from banks and other money market placements (net) | 2.37% | 192,418 | 57,400 | - | - | 110,364 | 360,182 |
| Loans, advances and financing activities for customers (net) | 5.36% | 2,232,168 | 1,560,462 | 1,725,260 | 1,375,281 | - | 6,893,171 |
| Financial investments | 3.45% | 23,260 | 19,506 | 141,153 | 192,849 | 98,868 | 475,636 |
| Premises and equipment | N/A | - | - | - | - | 170,896 | 170,896 |
| Other assets | N/A | - | - | - | - | 118,922 | 118,922 |
| **Total assets** | | **2,447,846** | **1,637,368** | **1,866,413** | **1,568,130** | **1,494,144** | **9,013,901** |
| Due to banks and other money market deposits | 5.22% | 307,507 | 10,073 | - | - | 9,062 | 326,642 |
| Customers' deposits and unrestricted investment accounts | 1.64% | 818,743 | 2,858,927 | 709,969 | - | 2,005,262 | 6,392,901 |
| Euro medium term notes | 3.02% | - | - | 599,756 | - | - | 599,756 |
| Other liabilities | N/A | 4,629 | - | - | - | 185,883 | 190,512 |
| Taxation | N/A | - | - | - | - | 20,301 | 20,301 |
| Tier 1 Perpetual Bond | 7.88% | - | - | 300,000 | - | - | 300,000 |
| Subordinated debt | 5.09% | - | 18,182 | 46,753 | - | - | 64,935 |
| Shareholders' equity | N/A | - | - | - | - | 1,118,854 | 1,118,854 |
| **Total liabilities and shareholders' equity** | | **1,130,879** | **2,887,182** | **1,656,478** | **-** | **3,339,362** | **9,013,901** |
| **Total interest rate sensitivity gap** | | **1,316,967** | **(1,249,81)** | **209,935** | **1,568,130** | **(1,845,218)** | **-** |
| **Cumulative interest rate sensitivity gap** | | **1,316,967** | **67,153** | **277,088** | **1,845,218** | **-** | **-** |

- **Currency risk**

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. The Bank has set limits on open positions by currency. Positions are monitored on a daily basis and hedging strategies used to ensure positions are maintained within established limits.

The foreign exchange positions in the books of the Bank are generally small residual positions resulting from market coverings for customer transactions.

Foreign exchange VAR is computed monthly for all non-pegged currencies at 99% confidence level and a holding period of 10 days. Additionally earnings impact of a 15% adverse movement in exchange rates for all open positions is factored in the monthly stress tests.

## 30 Risk management (continued)

### 30.4 Operational risk (continued)

The Bank had the following significant net exposures denominated in foreign currencies:

| 2017 USD'000 | 2018 USD'000 | | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|---|
| 166,571 | **169,366** | US Dollar | **65,206** | 64,130 |
| 78,753 | **82,436** | UAE Dirham | **31,738** | 30,320 |
| 7,369 | **3,387** | Others | **1,304** | 2,837 |

Operational risk is the risk of loss arising from systems failure, human error, frauds or external events. When controls fail to perform, operational risks can cause damage to reputation, have legal or regulatory implications, or lead to financial loss. The Bank cannot expect to eliminate all operational risks, but through a control framework and by monitoring and responding to potential risks, the Bank is able to manage the risks. Controls include effective segregation of duties, access, authorization and reconciliation procedures, staff training and assessment processes, including the use of internal audit. Further, the Bank has established an operational loss appetite statement to monitor losses under various operational loss categories and any breaches of set-off thresholds are reported to the Board Risk Committee. In addition to this, the Bank has an operational loss reporting database.

Information Security is an essential component of Operational Risk Management. The Bank has implemented the latest security infrastructure like firewalls, intrusion prevention systems, anti-virus soft wares, etc. Periodic vulnerability assessments are conducted to ensure the security of the systems.

As a part of Business Continuity Management initiatives, the bank has taken necessary actions to ensure effective measures in case of a crisis situation, e.g. evacuation drills, testing of critical systems and applications from the Disaster Recovery site. The Bank has the capability to ensure that critical banking processes are tested to ascertain availability during such situations.

**Fraud Risk**

The bank has adopted a 'zero tolerance' policy towards fraud and corruption and as such will seek to take disciplinary and/or legal action against those who perpetrate, are involved in, or assist with fraudulent or improper activities. The Fraud risk management (FRM) unit manages the fraud risk for the bank at an enterprise level. The unit monitors transactions originating from Cards, POS and other Digital channels. Besides, the unit conducts Fraud Risk Assessments to assess fraud risks on a pro-active basis, verifies the existing controls and proposes new controls, if required.

The unit is also responsible for managing Incidents across the bank and maintenance of Operational Loss Database.

### 30.5 Strategic risk

The Bank monitors strategic risks through regular quarterly assessment and reporting at the Board Risk Committee level. This includes reviews of human resource, economic (both at the macro and micro levels), regulatory/compliance, information technology and information security, legal and reputational related risks and the monitoring of strategic project risk arising from initiatives undertaken by the bank. Furthermore, the Bank is currently augmenting its Internal Capital Adequacy Assessment Process (ICAAP) to align the business strategy and the capital management processes. In the course of 2017 the Bank had engaged an internationally renowned consultant to review the current ICAAP process and to recommend enhancements that will, once implemented, escalate the ICAAP process and documentation to international best practices. This initiative was proposed and sponsored at the highest level by the Board Risk Committee and it will be rolled out in 2018 and progressively completed for the next 2-3 years.

Notes to the Financial Statements
As at 31 December 2018

## 31 Concentrations

The bank seeks to manage its credit risk exposure through diversification of lending activities to avoid undue concentrations of risk with individuals or groups of customers in specific locations or businesses. It also obtains security when appropriate.

The distribution of assets, liabilities and contingent items by geographical regions as of 31 December 2018 is as follows:

| | Sultanate of Oman RO'000 | UAE RO'000 | Egypt RO'000 | Others RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Cash and balances with Central Banks | 300,087 | 12,463 | 2,505 | - | 315,055 |
| Due from banks and other money market placements (net) | 9,042 | 6,959 | 2,024 | 80,039 | 98,064 |
| Loans, advances and financing activities for customers (net) | 2,732,615 | 68,192 | 1 | 8,899 | 2,809,707 |
| Financial investments | 220,703 | 8,013 | - | 2,433 | 231,149 |
| Premises and equipment | 63,510 | 709 | 141 | - | 64,360 |
| Other assets | 43,554 | 10,553 | 480 | - | 54,587 |
| **Total assets** | **3,369,511** | **106,889** | **5,151** | **91,371** | **3,572,922** |
| Due to banks and other money market deposits | 6,470 | 16,430 | 19,250 | 113,799 | 155,949 |
| Customers' deposits and unrestricted investment accounts | 2,403,477 | 47,707 | 1,198 | - | 2,452,382 |
| Euro medium term notes | 307,148 | - | - | - | 307,148 |
| Other liabilities | 89,456 | 3,708 | 370 | - | 93,534 |
| Taxation | 9,776 | 591 | 52 | - | 10,419 |
| Subordinated debt | 17,000 | - | - | - | 17,000 |
| Tier 1 perpetual bond | 427,462 | (8,530) | 2,058 | - | 420,990 |
| Shareholders' equity | 115,500 | - | - | - | 115,500 |
| **Liabilities and shareholders' equity** | **3,376,289** | **59,906** | **22,928** | **113,799** | **3,572,922** |
| **Contingent liabilities** | **388,605** | **43,256** | **6,935** | **30,905** | **469,701** |

## 31 Concentrations (continued)

| | Sultanate of Oman USD'000 | UAE USD'000 | Egypt USD'000 | Others USD'000 | Total USD'000 |
|---|---|---|---|---|---|
| Cash and balances with Central Banks | 779,448 | 32,371 | 6,506 | - | 818,325 |
| Due from banks and other money market placements (net) | 23,486 | 18,075 | 5,257 | 207,894 | 254,712 |
| Loans, advances and financing activities for customers (net) | 7,097,701 | 177,122 | 3 | 23,114 | 7,297,940 |
| Financial investments | 573,255 | 20,813 | - | 6,319 | 600,387 |
| Premises and equipment | 164,961 | 1,842 | 366 | - | 167,169 |
| Other assets | 113,126 | 27,410 | 1,247 | - | 141,783 |
| **Total assets** | **8,751,977** | **277,633** | **13,379** | **237,327** | **9,280,316** |
| Due to banks and other money market deposits | 16,805 | 42,675 | 50,000 | 295,582 | 405,062 |
| Customers' deposits and unrestricted investment accounts | 6,242,797 | 123,914 | 3,112 | - | 6,369,823 |
| Euro medium term notes | 797,787 | - | - | - | 797,787 |
| Other liabilities | 232,353 | 9,631 | 961 | - | 242,945 |
| Taxation | 25,392 | 1,535 | 135 | - | 27,062 |
| Subordinated debt | 44,156 | - | - | - | 44,156 |
| Tier 1 perpetual bond | 1,110,292 | (22,156) | 5,345 | - | 1,093,481 |
| Shareholders' equity | 300,000 | - | - | - | 300,000 |
| **Liabilities and shareholders' equity** | **8,769,582** | **155,599** | **59,553** | **295,582** | **9,280,316** |
| **Contingent liabilities** | **1,009,363** | **112,354** | **18,013** | **80,273** | **1,220,003** |

Notes to the Financial Statements
As at 31 December 2018

## 31 Concentrations (continued)

The distribution of assets, liabilities and off balance sheet items by geographical regions as of 31 December 2017 is as follows:

| | Sultanate of Oman RO'000 | UAE RO'000 | Egypt RO'000 | Others RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Cash and balances with Central Banks | 361,419 | 19,182 | 2,510 | - | 383,111 |
| Due from banks and other money market placements (net) | 26,357 | 14,255 | 1 | 98,057 | 138,670 |
| Loans, advances and financing activities for customers (net) | 2,537,245 | 107,724 | 3 | 8,899 | 2,653,871 |
| Financial investments | 171,711 | 9,252 | - | 2,157 | 183,120 |
| Premises and equipment | 65,096 | 556 | 143 | - | 65,795 |
| Other assets | 34,888 | 10,394 | 503 | - | 45,785 |
| **Total assets** | 3,196,716 | 161,363 | 3,160 | 109,113 | 3,470,352 |
| Due to banks and other money market deposits | 508 | 26,135 | 13 | 99,101 | 125,757 |
| Customers' deposits and unrestricted investment accounts | 2,418,602 | 41,488 | 1,177 | - | 2,461,267 |
| Euro medium term notes | 230,906 | - | - | - | 230,906 |
| Other liabilities | 67,271 | 5,764 | 312 | - | 73,347 |
| Taxation | 6,673 | 1,032 | 111 | - | 7,816 |
| Subordinated debt | 25,000 | - | - | - | 25,000 |
| Shareholders; equity | 429,979 | (1,213) | 1,993 | - | 430,759 |
| Tier 1 perpetual bond | 115,500 | - | - | - | 115,500 |
| **Liabilities and shareholders' equity** | 3,294,439 | 73,206 | 3,606 | 99,101 | 3,470,352 |
| **Contingent liabilities** | 396,486 | 26,304 | 10 | 24,307 | 447,107 |

## 31 Concentrations (continued)

The distribution of assets, liabilities and off balance sheet items by geographical regions as of 31 December 2017 is as follows:

| | Sultanate of Oman USD'000 | UAE USD'000 | Egypt USD'000 | Others USD'000 | Total USD'000 |
|---|---|---|---|---|---|
| Cash and balances with Central Banks | 938,752 | 49,823 | 6,519 | - | 995,094 |
| Due from banks and other money market placements (net) | 68,460 | 37,026 | 3 | 254,693 | 360,182 |
| Loans, advances and financing activities for customers (net) | 6,590,246 | 279,803 | 8 | 23,114 | 6,893,171 |
| Financial investments | 446,002 | 24,031 | - | 5,603 | 475,636 |
| Premises and equipment | 169,081 | 1,444 | 371 | - | 170,896 |
| Other assets | 90,618 | 26,998 | 1,306 | - | 118,922 |
| **Total assets** | 8,303,159 | 419,125 | 8,207 | 283,410 | 9,013,901 |
| Due to banks and other money market deposits | 1,319 | 67,883 | 34 | 257,406 | 326,642 |
| Customers' deposits and unrestricted investment accounts | 6,282,083 | 107,761 | 3,057 | - | 6,392,901 |
| Euro medium term notes | 599,756 | - | - | - | 599,756 |
| Other liabilities | 174,731 | 14,971 | 810 | - | 190,512 |
| Taxation | 17,332 | 2,681 | 288 | - | 20,301 |
| Subordinated debt | 64,935 | - | - | - | 64,935 |
| Shareholders' equity | 1,116,828 | (3,151) | 5,177 | - | 1,118,854 |
| Tier 1 perpetual bond | 300,000 | - | - | - | 300,000 |
| **Liabilities and shareholders' equity** | 8,556,984 | 190,145 | 9,366 | 257,406 | 9,013,901 |
| **Contingent liability** | 1,029,834 | 68,322 | 26 | 63,135 | 1,161,317 |

## 32 Segmental information

For management purposes, the Bank is organised into four operating segments based on business units and are as follows:

- Retail banking offers various products and facilities to individual retail and high networth customers to meet everyday banking needs. This includes asset products like personal loans, housing loan, credit cards and term loans and liability products like savings account, current account and term deposits.
- Wholesale banking delivers a variety of products and services to corporate customers that include lending, accepting deposits, trade finance, treasury and foreign exchange. It also includes investment banking which offers investment products such as asset management, corporate advisory and brokerage services to retail customers and institutional clients.
- Commercial banking covers the mid-tier corporate and SME customers offering the entire spectrum of products to suit their business needs. It also includes international operations of UAE and Egypt and Islamic banking which offers products as per Shari'a principles.
- Funding Center – The Funding center is responsible for balancing and managing the liquidity of funds within the bank. It acts as repository of funds by allocating funds transfer pricing to various business units for performance management purposes. The department also handles the Bank's investments in securities, asset/liability management and cash instruments.

Management monitors the operating results of these segments separately for the purpose of making decisions about resource allocation and performance assessment. The costs incurred by the central functions are managed on a group basis and are not allocated to operating segments.

## 32 Segmental information (continued)

Segment information by business line is as follows:

| Year ended 31 December 2018 | Retail banking RO'000 | Wholesale banking RO'000 | Commercial banking RO'000 | Funding center RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Net Interest income and Income from Islamic financing and Investment activities | 42,959 | 33,177 | 12,183 | 4,060 | 92,379 |
| Other income | 14,289 | 18,643 | 3,758 | (54) | 36,636 |
| Total income | 57,248 | 51,820 | 15,941 | 4,006 | 129,015 |
| Operating expenditure | 20,854 | 5,503 | 7,641 | 27,744 | 61,742 |
| Operating profit | 21,790 | 39,371 | 2,107 | 4,005 | 67,273 |
| Loan impairment | (802) | 929 | (7,718) | 194 | (7,397) |
| Net profit before tax | 20,988 | 40,300 | (5,611) | 4,199 | 59,876 |
| Taxation | (3,126) | (6,004) | 488 | (626) | (9,268) |
| **Net profit after tax** | **17,862** | **34,296** | **(5,123)** | **3,573** | **50,608** |
| **Total assets** | **1,311,460** | **1,288,051** | **402,491** | **570,920** | **3,572,922** |
| **Total liabilities and equity** | **816,271** | **1,381,208** | **387,227** | **988,216** | **3,572,922** |

| Year ended 31 December 2018 | Retail banking USD'000 | Wholesale banking USD'000 | Commercial banking USD'000 | Funding center USD'000 | Total USD'000 |
|---|---|---|---|---|---|
| Net Interest income and Income from Islamic financing and Investment activities | 111,582 | 86,174 | 31,644 | 10,545 | 239,945 |
| Other income | 37,114 | 48,423 | 9,761 | (140) | 95,158 |
| Total income | 148,696 | 134,597 | 41,405 | 10,405 | 335,103 |
| Operating expenditure | 54,166 | 14,294 | 19,847 | 72,062 | 160,369 |
| Operating profit | 56,596 | 102,262 | 5,473 | 10,403 | 174,734 |
| Loan impairment | (2,083) | 2,413 | (20,047) | 504 | (19,213) |
| Net profit before tax | 54,513 | 104,675 | (14,574) | 10,907 | 155,521 |
| Taxation | (8,122) | (15,595) | 1,268 | (1,624) | (24,073) |
| **Net profit after tax** | **46,391** | **89,080** | **(13,306)** | **9,283** | **131,448** |
| **Total assets** | **3,406,391** | **3,345,586** | **1,045,430** | **1,482,909** | **9,280,316** |
| **Total liabilities and equity** | **2,120,186** | **3,587,552** | **1,005,783** | **2,566,795** | **9,280,316** |

For management purposes the bank also reports the segment information of its operations by the following geographical locations:

i) Oman

ii) United Arab Emirates (UAE)

iii) Egypt

Transactions between the above segments are conducted at estimated market rates on an arm's length basis.



Notes to the Financial Statements
As at 31 December 2018

## 32 Segmental information (continued)

Segment information by geography is as follows:

| For the year ended 31 December 2018 | Oman RO'000 | UAE RO'000 | Egypt RO'000 | Total RO'000 |
|---|---|---|---|---|
| Interest income and Income from Islamic financing and Investment activities | 154,438 | 3,931 | 560 | 158,929 |
| Other operating income | 35,628 | 1,006 | 2 | 36,636 |
| **Total income** | **190,066** | **4,937** | **562** | **195,565** |
| Interest costs and Unrestricted investment account holders' share of profit | 65,300 | 1,187 | 63 | 66,550 |
| Other operating expenses | 53,214 | 3,646 | 425 | 57,285 |
| Depreciation | 4,339 | 118 | - | 4,457 |
| Credit loss expense–customer loan | 7,732 | 10,756 | - | 18,488 |
| Recoveries | (10,077) | (1,021) | - | (11,098) |
| Impairment losses on available-for-sale investments | 85 | 4 | - | 89 |
| Credit loss write back – bank loans | (84) | - | 2 | (82) |
| Taxation | 11,057 | (1,796) | 7 | 9,268 |
| **Total** | **131,566** | **12,894** | **497** | **144,957** |
| **Segment profit for the year** | 58,500 | (7,957) | 65 | 50,608 |
| **Other information** | | | | |
| **Segment assets** | **3,446,407** | **106,459** | **20,056** | **3,572,922** |
| **Segment capital expenses** | **2,768** | **275** | **-** | **3,043** |

| For the year ended 31 December 2018 | Oman USD'000 | UAE USD'000 | Egypt USD'000 | Total USD'000 |
|---|---|---|---|---|
| Interest income and Income from Islamic financing and Investment activities | 401,137 | 10,210 | 1,455 | 412,802 |
| Other operating income | 92,540 | 2,613 | 5 | 95,158 |
| **Total income** | **493,677** | **12,823** | **1,460** | **507,960** |
| Interest costs and Unrestricted investment account holders' share of profit | 169,611 | 3,083 | 163 | 172,857 |
| Other operating expenses | 138,218 | 9,470 | 1,104 | 148,792 |
| Depreciation | 11,271 | 306 | - | 11,577 |
| Credit loss expense–customer loan | 20,083 | 27,938 | - | 48,021 |
| Recoveries | (26,174) | (2,652) | - | (28,826) |
| Impairment losses on available-for-sale investments | 221 | 10 | - | 231 |
| Credit loss write back – bank loans | (218) | - | 5 | (213) |
| Taxation | 28,720 | (4,665) | 18 | 24,073 |
| **Total** | **341,732** | **33,490** | **1,290** | **376,512** |
| **Segment profit for the year** | 151,945 | (20,667) | 170 | 131,448 |
| **Other information** | | | | |
| **Segment assets** | **8,951,705** | **276,517** | **52,094** | **9,280,316** |
| **Segment capital expenses** | **7,190** | **714** | **-** | **7,904** |

## 32 Segmental information (continued)

Segment information by geography is as follows:

| Year ended 31 December 2017 | Retail banking RO'000 | Wholesale banking RO'000 | Commercial banking RO'000 | Funding center RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Net Interest income and Income from Islamic financing and Investment activities | 42,428 | 31,977 | 15,650 | 7,477 | 97,532 |
| Other income | 13,837 | 17,046 | 3,709 | 5 | 34,597 |
| Total income | 56,265 | 49,023 | 19,359 | 7,482 | 132,129 |
| Operating expenditure | 24,023 | 5,179 | 8,601 | 26,715 | 64,518 |
| Operating profit | 18,098 | 37,153 | 4,897 | 7,463 | 67,611 |
| Loan impairment | (2,542) | 426 | (14,546) | 311 | (16,351) |
| Net profit before tax | 15,556 | 37,579 | (9,648) | 7,774 | 51,261 |
| Taxation | (2,440) | (5,895) | 2,319 | (1,219) | (7,235) |
| **Net profit after tax** | 13,116 | 31,684 | (7,329) | 6,555 | 44,026 |
| **Total assets** | 1,256,293 | 1,152,081 | 449,745 | 612,232 | 3,470,351 |
| **Total liabilities and equity** | 814,829 | 1,369,017 | 426,059 | 860,446 | 3,470,351 |

| Year ended 31 December 2017 | Retail banking USD'000 | Wholesale banking USD'000 | Commercial banking USD'000 | Funding center USD'000 | Total USD'000 |
|---|---|---|---|---|---|
| Net Interest income and Income from Islamic financing and Investment activities | 110,203 | 83,057 | 40,649 | 19,421 | 253,330 |
| Other income | 35,941 | 44,275 | 9,634 | 13 | 89,863 |
| Total income | 146,144 | 127,332 | 50,283 | 19,434 | 343,193 |
| Operating expenditure | 62,397 | 13,452 | 22,340 | 69,390 | 167,579 |
| Operating profit | 47,010 | 96,501 | 12,719 | 19,384 | 175,614 |
| Loan impairment | (6,601) | 1,106 | (37,782) | 808 | (42,469) |
| Net profit before tax | 40,409 | 97,607 | (25,063) | 20,192 | 133,145 |
| Taxation | (6,337) | (15,312) | 6,023 | (3,166) | (18,792) |
| **Net profit after tax** | 34,072 | 82,295 | (19,040) | 17,026 | 114,353 |
| **Total assets** | 3,263,101 | 2,992,418 | 1,168,169 | 1,590,213 | 9,013,901 |
| **Total liabilities and equity** | 2,116,441 | 3,555,888 | 1,106,647 | 2,234,925 | 9,013,901 |



Notes to the Financial Statements
As at 31 December 2018

## 32 Segmental information (continued)

Segment information by geography is as follows:

| For the year ended 31 December 2017 | Oman RO'000 | UAE RO'000 | Egypt RO'000 | Total RO'000 |
|---|---|---|---|---|
| Interest income and Income from Islamic financing and Investment activities | 146,886 | 8,396 | 422 | 155,704 |
| Other operating income | 33,224 | 1,365 | 8 | 34,597 |
| **Total Income** | **180,110** | **9,761** | **430** | **190,301** |
| Interest costs and Unrestricted investment account holders' share of profit | 55,585 | 2,531 | 56 | 58,172 |
| Other operating expenses | 55,466 | 4,624 | 216 | 60,306 |
| Depreciation | 4,080 | 132 | - | 4,212 |
| Credit loss expense–customer loan | 11,141 | 13,972 | - | 25,113 |
| Recoveries | (7,798) | (1,604) | (75) | (9,477) |
| Impairment losses on available-for-sale investments | 688 | - | - | 688 |
| Credit loss write back – bank loans | 26 | - | - | 26 |
| Taxation | 9,962 | (2,736) | 9 | 7,235 |
| **Total** | **129,150** | **16,919** | **206** | **146,275** |
| **Segment profit for the year** | 50,960 | (7,158) | 224 | 44,026 |
| **Other information** | | | | |
| **Segment assets** | **3,296,610** | **153,732** | **20,010** | **3,470,352** |
| **Segment capital expenses** | **23,479** | **201** | **-** | **23,680** |

| For the year ended 31 December 2017 | Oman USD'000 | UAE USD'000 | Egypt USD'000 | Total USD'000 |
|---|---|---|---|---|
| Interest income and income from Islamic financing and Investment activities | 381,522 | 21,808 | 1,096 | 404,426 |
| Other operating income | 86,296 | 3,545 | 21 | 89,862 |
| **Total Income** | 467,818 | 25,353 | 1,117 | 494,288 |
| Interest costs and Unrestricted investment account holders' share of profit | 144,377 | 6,574 | 145 | 151,096 |
| Other operating expenses | 144,068 | 12,010 | 561 | 156,639 |
| Depreciation | 10,597 | 343 | - | 10,940 |
| Credit loss expense–customer loan | 28,938 | 36,291 | - | 65,229 |
| Recoveries | (20,254) | (4,166) | (195) | (24,615) |
| Impairment losses on available-for-sale investments | 1,787 | - | - | 1,787 |
| Credit loss write back – bank loans | 68 | - | - | 68 |
| Taxation | 25,875 | (7,106) | 23 | 18,792 |
| **Total** | 335,456 | 43,946 | 534 | 379,936 |
| **Segment profit for the year** | 132,362 | (18,593) | 583 | 114,352 |
| **Other information** | | | | |
| **Segment assets** | 8,562,623 | 399,304 | 51,974 | 9,013,901 |
| **Segment capital expenses** | 60,984 | 522 | - | 61,506 |

## 33 Fair value of financial instruments

Based on the valuation methodology outlined below, the fair values of all financial instruments at 31 December 2018 are considered by the Management not to be materially different to their book values.

### Estimation of fair values

The following summarises the major methods and assumptions used in estimating the fair values of assets and liabilities:

### Loans and advances

Fair value is calculated based on discounted expected future principal and interest cash flows. Loan repayments are assumed to occur at contractual repayment dates, where applicable. For loans that do not have fixed repayment dates or that are subject to prepayment risk, repayments are estimated based on experience in previous periods when interest rates were at levels similar to current levels, adjusted for any differences in interest rate outlook. Expected future cash flows are estimated considering credit risk and any indication of impairment. Expected future cash flows for homogeneous categories of loans are estimated on a portfolio basis and discounted at current rates offered for similar loans to new borrowers with similar credit profiles. The estimated fair values of loans reflect changes in credit status since the loans were made and changes in interest rates in the case of fixed rate loans.

### Investments

Fair value is based on quoted market prices at the reporting date without any deduction for transaction costs. If a quoted market price is not available, fair value is estimated based on discounted cash flow and other valuation techniques.

Where discounted cash flow techniques are used, estimated future cash flows are based on management's best estimates and the discount rate is a market-related rate for a similar instrument at the reporting date.

### Current account balances due to and due from banks

The carrying amount of current account balances due to and from banks was considered to be a reasonable estimate of fair value due to their short term nature.

### Bank and customer deposits

For demand deposits and deposits with no defined maturities, fair value is taken to be the amount payable on demand at the reporting date. The estimated fair value of fixed-maturity deposits, including certificates of deposit, is based on discounted cash flows using rates currently offered for deposits of similar remaining maturities. The value of long-term relationships with depositors is not taken into account in estimating fair values.

### Other financial instruments

No fair value adjustment is made with respect to credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams materially reflect contractual fees and commissions actually charged at the reporting date for agreements of similar credit standing and maturity.

Foreign exchange contracts are valued based on market prices. The market value adjustments in respect of foreign exchange contracts are included in other assets and other liabilities.

The fair values of financial instruments that are traded in active markets are based on quoted market prices or dealer price quotations. Other unquoted equities are valued based on information provided by fund managers, investee financial information and current purchase prices.

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

### Valuation models

**Level 1:** inputs that are quoted market prices (unadjusted) in active markets for identical instruments.

**Level 2**: inputs other than quoted prices included within Level 1 that are observable either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data.

**Level 3:** inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect differences between the instruments.

Notes to the Financial Statements
As at 31 December 2018

## 33 Fair value of financial instruments (continued)

The following table shows an analysis of financial instruments other than derivatives instruments recorded at fair value by level of the fair value hierarchy:

| Total USD'000 | Level 2 USD'000 | Level 1 USD'000 | 31 December 2018 | Level 1 RO'000 | Level 2 RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|
| | | | **Investment measured at FVTPL** | | | |
| 13,704 | - | 13,704 | Quoted equities | 5,276 | - | 5,276 |
| 6,273 | 6,273 | - | Unquoted equities | - | 2,415 | 2,415 |
| **19,977** | **6,273** | **13,704** | **Total** | **5,276** | **2,415** | **7,691** |
| | | | **Investment measured at FVOCI** | | | |
| 73,623 | - | 73,623 | Quoted equities | 28,345 | - | 28,345 |
| 860.00 | 860 | - | Unquoted equities | - | 331 | 331 |
| **74,483** | **860** | **73,623** | **Total** | **28,345** | **331** | **28,676** |
| **94,460** | **7,133** | **87,327** | **Total financial assets** | **33,621** | **2,746** | **36,367** |

| Total USD'000 | Level 2 USD'000 | Level 1 USD'000 | 31 December 2017 | | Level 1 RO'000 | Level 2 RO'000 |
|---|---|---|---|---|---|---|
| | | | **Investments – held for trading:** | | | |
| 143,431 | - | 143,431 | Government development bonds | 55,221 | - | 55,221 |
| 1,429 | - | 1,429 | Quoted bond | 550 | - | 550 |
| 144,860 | - | 144,860 | **Total** | 55,771 | - | 55,771 |
| | | | **Investments–available-for-sale:** | | | |
| 10,117 | - | 10,117 | Government development bonds | 3,895 | - | 3,895 |
| 67,210 | - | 67,210 | Quoted equities | 25,876 | - | 25,876 |
| 20,231 | 20,231 | - | Other unquoted equities | - | 7,789 | 7,789 |
| 97,558 | 20,231 | 77,327 | **Total** | 29,771 | 7,789 | 37,560 |
| 242,418 | 20,231 | 222,187 | **Total financial assets** | 85,542 | 7,789 | 93,331 |

The Bank's primary medium and long-term financial liabilities are the borrowed funds and subordinated liabilities. The fair values of these financial liabilities not materially different from their carrying values, since these liabilities are repriced at intervals of three or six months, depending on the terms and conditions of the instrument and the resultant applicable margins approximate the current spreads that would apply for borrowings with similar maturities.

Derivative financial instrument at level 2 are valued based on counter party valuation, quoted forward rates and yield curves (see note 34).

Notes to the Financial Statements
As at 31 December 2018

## 34 Derivatives

In the ordinary course of business the Bank enters into various types of transactions with customers and for own account for hedging purpose that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instrument, reference rate or index. The bank uses the following derivative financial instruments:

### Derivative product types

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

Swaps are contractual agreements between two parties to exchange movements in interest or foreign currency rates and equity indices, and (in the case of credit default swaps) to make payments with respect to defined credit events based on specified notional amounts.

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity, foreign currency or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

### Derivatives held or issued for hedging purposes

As part of its asset and liability management the Bank uses derivatives for hedging purposes in order to reduce its exposure to currency and interest rate risks. Hedging specific financial instruments and forecasted transactions as well as strategic hedging against overall balance sheet exposures achieve this.

The Bank uses forward foreign exchange contracts, options and currency swaps to hedge against specifically identified currency risks. In addition, the Bank uses interest rate swaps to hedge against the cash flow risks arising from certain fixed interest rate loans and deposits.

For interest rate risk strategic hedging is carried out by monitoring the re-pricing of financial assets and liabilities and entering into interest rate swaps to hedge a proportion of the interest rate exposure.

The Bank has entered into an interest rate swap, which is designated as a fair value hedge, for hedging the interest rate risk on Euro medium term notes. The cumulative change in the fair value of the Euro medium term notes (hedged item) attributable to the risk hedged is recorded as part of the carrying value of the Euro medium term notes and accordingly presented in statement of financial position.

The table below shows the positive and negative fair values of derivative financial instruments entered with and on behalf of customers, which are equivalent to the market values, together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured.

## 34 Derivatives (continued)

| 31 December 2018 | Positive fair value RO'000 (note 9) | Negative fair value RO'000 (note 13) | Notional amount RO'000 | Notional amounts by term to maturity | | |
|---|---|---|---|---|---|---|
| | | | | Within 3 months RO'000 | 3–12 months RO'000 | 1–5 years RO'000 |
| Fair value hedge | - | (852) | 115,500 | - | 115,500 | - |
| Interest rate swaps | 126 | (126) | 39,138 | 6,998 | 12,280 | 19,860 |
| Forward foreign exchange purchase contracts | 101 | (224) | 180,987 | 144,358 | 36,408 | 221 |
| Forward foreign exchange sales contracts | 219 | (65) | 180,987 | 144,249 | 36,375 | 363 |
| Currency options | 4 | (4) | 533 | 206 | - | 327 |
| Total | 450 | (1,271) | 517,145 | 295,811 | 200,563 | 20,771 |
| Total – USD'000 | 1,169 | (3,301) | 1,343,234 | 768,340 | 520,943 | 53,951 |

| 31 December 2017 | Positive fair value RO'000 (note 9) | Negative fair value RO'000 (note 13) | Notional amount RO'000 | Notional amounts by term to maturity | | |
|---|---|---|---|---|---|---|
| | | | | Within 3 months RO'000 | 3–12 months RO'000 | 1–5 years RO'000 |
| Fair value hedge | - | (94) | 192,500 | - | - | 192,500 |
| Interest rate swaps | 1,842 | (1,842) | 95,238 | 6,285 | 13,971 | 74,982 |
| Forward purchase contracts | 508 | (122) | 212,849 | 175,508 | 13,879 | 23,462 |
| Forward sales contracts | 345 | (910) | 212,849 | 168,623 | 20,710 | 23,516 |
| Currency options | 6 | (6) | 13,193 | 8,579 | 4,614 | - |
| Total | 2,701 | (2,974) | 726,629 | 358,995 | 53,174 | 314,460 |
| Total – USD'000 | 7,016 | (7,725) | 1,887,348 | 932,455 | 138,114 | 816,779 |

## 35 Comparative amounts

During the current year, the Bank reclassified income from fixed income investments from investment income to Interest income. Further regrouped costs of certain currency swaps which is in the nature of interest costs from profit on exchange to interest expenses. The above reclassifications have resulted in changes as presented below for the comparative figures of 2017 to maintain consistency.

| | 31 December 2017 (as previously reported) | Reclassification | 2017 (as reported) |
|---|---|---|---|
| | RO'000 | RO'000 | RO'000 |
| Interest Income | 150,387 | 5,317 | 155,704 |
| Interest Expense | (57,457) | (715) | (58,172) |
| Other operating income | 39,199 | (4,602) | 34,597 |
| **Total** | **132,129** | **-** | **132,129** |

| | 31 December 2017 (as previously reported) | Reclassification | 2017 (as reported) |
|---|---|---|---|
| | USD'000 | USD'000 | USD'000 |
| Interest Income | 390,616 | 13,810 | 404,426 |
| Interest Expense | (149,239) | (1,857) | (151,096) |
| Other operating income | 101,816 | (11,953) | 89,862 |
| **Total** | **343,192** | **-** | **343,192** |

# Muzn Islamic Banking

EY
Building a better working world

Ernst & Young LLC
P.O. Box 1750, Ruwi 112
5th Floor, Landmark Building
Opposite Al Ameen Mosque
Bowsher, Muscat
Sultanate of Oman

Tel: +968 22 504 559
Fax: +968 22 060 810
muscat@om.ey.com
ey.com/mena
C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

## REPORT ON FACTUAL FINDINGS TO THE BOARD OF DIRECTORS OF NATIONAL BANK OF OMAN SAOG (THE "BANK") IN RESPECT OF BASEL II - PILLAR III AND BASEL III RELATED DISCLOSURES OF MUZN ISLAMIC BANKING WINDOW

We have performed the procedures agreed with you and as prescribed in Title 5 of the Islamic Banking Regulatory Framework and Central Bank of Oman's (CBO) Circular No. BM 1027 dated 4 December 2007 with respect to the Basel II - Pillar III Disclosures and Basel III Disclosures (the disclosures) of Muzn Islamic Banking Window (the Islamic Window) of the Bank as at and for the year ended 31 December 2018. The disclosures were prepared by the Islamic Window's management in accordance with the related requirements set out in Title 5 of the Islamic Banking Regulatory Framework, CBO's Circular number BM 1009 dated 13 September 2006, Circular No. BM 1027 dated 4 December 2007 and Circular No. 1114 dated 17 November 2013. Our engagement was undertaken in accordance with the International Standard on Related Services applicable to agreed-upon procedures engagements. The procedures, as set out in Title 5 of Islamic Banking Regulatory Framework and Circular number BM 1027 dated 4 December 2007 were performed solely to assist you in evaluating the Islamic Window's compliance with the related disclosure requirements as set out in Title 5 of Islamic Banking Regulatory Framework, CBO's Circular number BM 1009 dated 13 September 2006 and Circular No. BM 1114 dated 17 November 2013.

We report our findings as follows:

Based on performance of the procedures detailed above, we found the disclosures free from any material misrepresentation.

Because the above procedures do not constitute either an audit or a review made in accordance with International Standards on Auditing or International Standards on Review Engagements, we do not express any assurance on the disclosures.

Had we performed additional procedures or had we performed an audit or review of the disclosures in accordance with the International Standards on Auditing or International Standards on Review Engagements, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose. This report relates only to the accompanying disclosures to be included in the Bank's annual report for the year ended 31 December 2018 and does not extend to any financial statements of the Bank or its Islamic Window, taken as a whole or to any other reports of the Bank or its Islamic Window.

Ernst & Young LLC

ارنست ويونغ ش م م
ERNST & YOUNG LLC
C.R. No. 12
P.O. Box 1750 - P.C. 11

10 March 2019
Muscat



مزن للصيرفة الإسلامية
Muzn Islamic Banking

December 31, 2018
Report of Shari'a Supervisory Board
Muzn Islamic Banking Services
National Bank of Oman,
Oman.

In the name of Allah, the Beneficent, The Merciful

To the Shareholders of Muzn Islamic Banking Services

*Assalam Alaikum Wa Rahmat Allah Wa Barakatuh*

In compliance with the Letter of appointment, we are required to submit the following report:

We have reviewed the principles and the contracts relating to the transactions and applications introduced by the Muzn Islamic Banking Services during the period ended. We have also conducted our review to form an opinion as to whether the Muzn Islamic Banking Services complied with Shari principles and also with the specific Fatawa, rulings and guidelines issued by us.

We conducted our review which included examining, on a test basis, of each type of transactions, the relevant documentation and procedures adopted by the Muzn Islamic Banking Services.

We planned and performed our review so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Muzn Islamic Banking Services has not violated Shari'a principles. In our opinion:

a) The Contracts, transactions, and dealings entered into by the Muzn Islamic Banking Services during the year ended 31st December 2018 that we have reviewed are in compliance with Shari'a principles.

b) The allocation of profit & charging of losses relating to investment account conform to the basis that had been approved by us in accordance with Shari'a principles.

c) Earnings that have been realized from sources or by means prohibited by Shari'a principle have been identified and segregated for disposal to charity.

d) Calculation and payment of Zakah is the individual responsibility of Shareholders and Depositors.

We beg Allah the Almighty to grant us all the success and straight forwardness.

*Wassalam Alaikum Wa Rahmat Allah Wa Barakatuh*

Sheikh Dr. Mohamed Bin Ali Elgari
Chairman Shari'a Supervisory Board

Sheikh Dr. Mohammed Daud Bakar
Muzn Shari'a Supervisory Board Member

Sheikh Saleh Bin Nasser Al Kharusi
Muzn Shari'a Supervisory Board Member

HH Dr. Adham Bin Turki Al Said
Muzn Non-Voting SSB Member

البنك الوطني العماني
NBO

مزن للصيرفة الإسلامية
**Muzn** Islamic Banking

*As per requirement of IBRF Title2, Clause No. 2.2.2.14*

Fatwa No. 01/2018
Foreign Currency Forward Cover based on Wa'ad concept

Muzn Shari'a Supervisory Board in its meeting no 01 of 2018 on 20th March 2018 held in Muscat-Oman pronounced as under:

1. Muzn Islamic Banking (MIB) enters into an arrangement of foreign currency transaction based on Waad Endorsed by Fiqh Council and AAOIFI, with another Financial Institution (FI) by executing a Memorandum of Understanding (MOU).

2. As per MOU, the FI provides a unilateral Promise to Purchase from Muzn Islamic Banking, an amount of foreign currency at an agreed exchange rate, on the settlement date in future.

3. By fixing the future rate and amount, the Promise to Purchase, effectively hedges the currency risk of Muzn Islamic Banking resulting from the foreign currency investment/financing.

4. On the Settlement Date of the Promise to Purchase the FI provides an Offer to execute the transaction as per the terms of the Promise to Purchase, Muzn may accepts the Offer and sell the agreed currency to FI by exchanging the counter values.

5. The juristic evidence with regards to trade in currencies can be evidenced in AAOIFI Shari'a Standard No. (1) – "Trading in Currencies".

   Muzn SSB reviewed the account features, terms and conditions as mentioned in the Foreign Currency Forward Cover based on Wa'ad concept, and found all in order from Shari'a point of view.

Allah Grants Success

Sheikh Dr. Mohamed bin Ali Elgari
Chairman Shari'a Supervisory Board

Sheikh Dr. Mohammed Daud Bakar
SSB Member

Sheikh Saleh Bin Nasser Al Kharusi
SSB Member

# Basel II and III - Pillar III 2018

Basel II and III – Pillar III Report 2018

## Introduction

Muzn Islamic Banking – Window of National Bank of Oman SAOG, was established in the Sultanate of Oman to carry out banking and other financial activities in accordance with Islamic Shari'a rules and regulations. Muzn operates under an Islamic Banking license granted by the Central Bank of Oman on 17 January 2013. Muzn's Shari'a Supervisory Board is entrusted to ensure adherence to Shari'a rules and principles in its transactions and activities. A complete set of financial statements of Muzn is included in the consolidated financial statements of the bank. This document presents Basel II, Pillar III disclosure pertaining to Muzn on a standalone basis. There is no restriction on the transfer of the funds from the bank towards Muzn. However, under the Islamic Banking regulatory framework (IBRF), Muzn cannot place funds with the bank. Muzn does not hold controlling interest in any other entity.

## Capital Structure

The assigned capital of the Muzn Islamic Banking as at 31 December 2018 is RO 13,500,000. Muzn's capital structure as at close of 31 December 2018, based on Central Bank of Oman's (CBO), guidelines is as follows:

| Elements of Capital | Amount in RO 000's |
|---|---|
| **Tier I Capital** | |
| **Local Banks** | |
| Paid-up capital | 13,500 |
| Share premium | - |
| Legal reserve | - |
| General reserve | - |
| Subordinated debt reserve | - |
| Stock dividend (proposed) | - |
| Retained earnings/loss* | (1,731) |
| **Common equity Tier 1 before regulatory adjustments** | **11,769** |
| **Deduction** | |
| Deferred tax asset | - |
| **Common equity Tier 1** | **11,769** |
| Tier I Capital after all deductions | 11,769 |
| **Tier II Capital** | |
| Revaluation reserves / Cumulative fair value gains or losses on available for sale instruments | - |
| General loan loss provision / General loan loss reserve | 601 |
| Subordinated debt (after amortization) | - |
| Total Tier II Capital | 601 |
| Total Regulatory Capital | 12,370 |
| Amount of investment account holders funds | 4,772 |
| Profit equalization reserve | 310 |
| Investment risk reserve | 118 |
| Total Investment account holders | 5,200 |

## Capital Adequacy

### Qualitative Disclosures:

The ultimate objectives of capital management are three fold:

- Ensure stability of the Islamic window by holding enough capital to cover unexpected loss.
- Enhance the efficiency of the Bank, by increasing the risk adjusted return at various levels of aggregation (and thereby ensuring that "excess" capital is not held unnecessarily).
- Incentivize informed decision making and proactive risk management through an efficient and effective allocation of capital across the business.

The capital management plan envisaged for Muzn is based on the regulatory risk capital framework of Basel II and uses the standardized approach for calculating the credit as well market risk, and the basic indicator approach for operational risk as prescribed by CBO.

The capital management policy is aligned to the policy of the Bank, and aims to ensure that on a risk adjusted return on capital basis (RAROC) Muzn is allocated an appropriate amount of capital. The RAROC model has been implemented for the entire portfolio except for Retail banking where the Central Bank of Oman has defined caps on profit rates, which are followed.

The Asset Liability Committee (ALCO) currently reviews and monitors capital adequacy and requirement for capital on an ongoing basis both for the Muzn window and its divisions that require capital to be assigned separately. Risk weights are assigned to assets as per regulatory requirements from CBO. Assets funded by investment accounts are also assigned same risk weights as assets funded by own equity.

### Qualitative Disclosures:

A set of triggers is followed as part of the capital management so as to provide the bank with an early warning system in terms of its level of capital, and to enable it to take suitable measures at an early stage to prevent capital falling below acceptable limits. For this purpose it has been decided by ALCO that the triggers set for the Bank will become applicable for Muzn as well.

The Bank prepares ICAAP (Internal Capital Adequacy Assessment Process) document in line with Basel II guidelines to evaluate all Enterprise-wide Risks that are not fully captured in the Pillar I Risks. Following the guidelines issued by the Central Bank of Oman in December 2012, assessment under ICAAP comprehensively for the whole bank is carried out and submitted to the Central Bank of Oman in accordance with the prescribed guidelines. The Bank will also factor in the regulatory guidelines, wherever applicable on Basel III, while carrying out its assessment. Currently, a separate ICAAP is not prepared for Muzn.

### Quantitative Disclosures:

Position as at 31.12.2018 (RO'000)

| Details | Amount |
|---|---|
| **Tier I Capital (after supervisory deductions)** | **11,769** |
| **Tier II Capital (after supervisory deductions & up to eligible limits)** | **601** |
| **Risk Weighted Assets (RWAs) – Banking Book** | **92,479** |
| **Risk Weighted Assets (RWAs) – Operational Risk** | **4,988** |
| **Total Risk Weighted Assets (RWAs) – Banking Book + Operational Risk** | **97,467** |
| Minimum required Capital to support RWAs of banking book and operational risk | 10,721 |
| Minimum required Capital comprises of; | |
| i) Tier I Capital | 11,769 |
| ii) Tier II Capital | 601 |
| Balance Tier I Capital available for supporting Trading Book | 1,649 |
| Balance Tier II Capital available for supporting Trading book | - |
| **Risk Weighted Assets (RWAs) – Trading Book** | **4** |
| Total Capital required to support Trading Book | 0.4 |
| Minimum Tier I Capital required for supporting Trading Book | 0.1 |
| **Total Regulatory Capital** | **12,370** |
| **Total Risk Weighted Assets – Islamic Window** | **97,471** |
| **BIS Capital Adequacy Ratio** | **12.7** |

Basel II and III – Pillar III Report 2018

## Basel III Disclosures:

In compliance with CBO circular BM 1114 dated 17 November 2013; mandatory disclosures are made in this report.

Certain additional capital adequacy disclosures are as follows:

Position as at 31.12.2018 (RO'000)

| Details | Gross balance (Book value) | Net balance (Book value) | Risk Weighted Assets |
|---|---|---|---|
| On balance sheet items | 142,457 | 141,131 | 91,361 |
| Off balance sheet items | 1,206 | 1,206 | 1,118 |
| Derivatives | - | - | - |
| Operational Risk | - | - | 4,988 |
| Market Risk | - | - | 4 |
| **Total** | **143,663** | **142,337** | **97,471** |
| Common equity Tier I Capital | 11,769 | - | - |
| Tier 2 Capital | 601 | - | - |
| Tier 3 Capital | - | - | - |
| **Total Regulatory Capital** | **12,370** | - | - |
| Total required Capital | 10,721 | - | - |
| Capital requirement for credit risk | 10,173 | - | - |
| Capital requirement for market risk | - | - | - |
| Capital requirement for operational risk | 549 | - | - |
| **Common equity Tier 1 Ratio** | 12.1 | - | - |
| **Tier I Ratio** | 12.1 | - | - |
| **Total Capital Ratio** | 12.7 | - | - |

## Disclosures for Investment Account Holders (IAH)

Muzn accepts funds from investment account holders (IAH) under Shari'a compliant Mudaraba contracts and Wakala agreements. These funds are unrestricted in nature i.e. it is at the discretion of Muzn to invest in any Shari'a compliant assets. There are no limits on the investment of IAH fund in any particular type of asset.

Currently, Muzn offers three types of Investment accounts:

- Savings accounts,
- Term deposits of various maturities from 1 month to five years and
- Flex Wakala

Investment from investment account holders (IAH) is pooled with Muzn's funds. Mudarib (Manager of assets) expenses are charged to a pool which includes all direct expenses incurred, including impairment provisions. Fee based income is not allocated to the joint pool. From the distributable profits earned by the pool assets, and after charging Mudarib expenses, allocation is made between shareholder funds and funds of IAH.

Under Wakala arrangement for Islamic Wakala Investment, the customer becomes the Principal (Muwakkil), and Muzn becomes the Investment Agent (Wakeel) for the funds invested by the customer. Muzn will accept deposits from Wakala Investment holders under a Wakala agreement and allocate these funds to an investment pool. While accepting the deposit from the customers, Bank informs the "Expected Targeted Profit Rate" on the deposit. Funds from this investment pool will be utilized to provide financing to customers under Islamic modes and to invest in other Shari'a compliant investments opportunities. The profit earned from the investment and financing activities from the investment pool, shall be paid to the investors (as the Muwakkil) based on their pre-assigned weightages less performance fee and the fixed fees payable to the bank (as a Wakeel). Investor's share of profit shall be returned to the investors together with the principal on maturity date.

Muzn appropriates an amount in excess of the profit to be distributed to investment account holders before taking into consideration the Mudarib (Manager of assets) share of income. This reserve is called Profit Equalization Reserve (PER).

## Ratios and returns

**Profit Equalization Reserve (PER) to Profit Sharing Investment Account (PSIA)**

| Particulars (RO'000) | 2018 | 2017 |
|---|---|---|
| Amount of total PER | 310 | 254 |
| Amount of PSIA by IAH | 4,772 | 4,600 |
| PER to PSIA Ratio | 6.50% | 5.53% |

**Investment Risk Reserves Reserve (PER) to Profit Sharing Investment Account (PSIA)**

| Particulars (RO'000) | 2018 | 2017 |
|---|---|---|
| Amount of total IRR | 118 | 93 |
| Amount of PSIA by IAH | 4,772 | 4,600 |
| IRR to PSIA Ratio | 2.47% | 2.02% |

**Return on Assets (ROA)**

| Particulars (RO'000) | 2018 | 2017 |
|---|---|---|
| Amount of total net income (before distribution of profit to unrestricted IAH) | 6,111 | 5,240 |
| Amount of assets | 141,131 | 134,304 |
| Return on assets (ROA) | 4.33% | 3.90% |

**Return on Equity (ROE)**

| Particulars (RO'000) | 2018 | 2017 |
|---|---|---|
| Amount of total net income (after distribution of profit to unrestricted IAH) | 2,547 | 2,098 |
| Amount of equity | 11,769 | 11,091 |
| Return on equity (ROE) | 21.65% | 18.92% |

## Rate of profit distributed to PSIA by type of IAH & Wakala Accounts

As at reporting date, Muzn has unrestricted IAH and Wakala Accounts and has distributed profit amounting RO 3,352,000 during the year.

Latest profit rates paid to investment account holders for quarter ended 31 December 2018.

| | Weightages | Declared Profit Rate |
|---|---|---|
| Savings Account (Mudarabah) | 20 | 0.77% |
| Flexi Wakala | 40 | 0.10% |
| Flexi Wakala – Elite | 50 | 2.25% |
| Flexi Wakala – Premium | 25 | 1.75% |
| Wakala – Upto 6 Months | 30 | 0.10% – 0.25% |
| Wakala – > 6 Months to 1 Year | 50 | 0.40% – 0.75% |
| Wakala – > 1 Year to 3 Years | 80 | 1.75% – 2.50% |
| Wakala – > 3 Years | 100 | 3.00% – 3.50% |
| Government Flexi Wakala | 50 | 1.00% |

Basel II and III – Pillar III Report 2018

### Jointly Funded Assets and Return to IAH

| | 31 December 2018 | 31 December 2017 |
|---|---|---|
| **Assets** | | |
| Deferred sale receivable under Murabaha | 1,569 | 1,665 |
| Ijarah Muntahia Bittamleek | 84,163 | 85,452 |
| Diminishing Musharaka | 26,125 | 11,008 |
| Forward Ijarah | 4,697 | 4,656 |
| Service Ijarah | 11 | - |
| **Total amount invested** | 116,565 | 102,781 |
| Share of profit of IAH before PER and IRR for the year | 3,433 | 3,142 |
| Transfers to: | | |
| PER | (56) | (56) |
| IRR | (25) | (25) |
| **Share of profit of IAH after PER and IRR for the year** | 3,352 | 3,061 |

## Risk Exposure and Assessment

### Risk Management

The primary objective of risk management is to appropriately safeguard the Bank's resources from the various risks which the Bank faces. Muzn's risk management incorporates the same essential principles and practices that govern the Bank's risk management which are detailed in the Bank's Basel II disclosures.

Bank's risk management processes have proven effective for Muzn throughout the current year. The Bank's Board of Directors has remained closely involved with key risk management initiatives, and ensured that Muzn's risks are effectively managed and adequate capital is held in line with the requirements. Detailed risk governance structure of the Bank, which is also applicable to Muzn is disclosed in the main Pillar III document of the Bank. In addition, a dedicated Shari'a Supervisory Board (SSB) has been established which reports to the Board of Directors of the bank and ensures Shari'a compliance in the operations of Muzn.

Specifically, Muzn has exposure to the following risks.

- Credit risk
- Liquidity risk
- Market risk
- Operational risk
- Rate of return risk, and
- Displaced commercial risk

### Credit Risk

Credit risk is the risk of financial loss to Muzn if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from Muzn's financings and advances to customers and other banks.

**Corporate Credit:**

Muzn manages and controls credit risk by setting internal limits on the amount of risk it is willing to accept for individual counterparties and groups (single obligors) and industry sectors in line with the guidelines of Central Bank of Oman.

Muzn has a conservative provisioning policy for its financings and provisions are made taking into account both the Central Bank's norms and international financial standards.

For risk management reporting purposes for the corporate portfolio, Muzn considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk).

**Retail Credit:**

Retail Credit Division manages the credit risk in the Muzn retail portfolio. The small retail credit portfolio is focused on Ijarah, Murabaha and Diminishing Musharaka product programs approved by the Board Risk Committee. Both corporate and retail credit portfolios are monitored by the management through periodic performance reports which are presented to the Board Risk Committee.

**Impairment Policy:**

All financing contracts of Muzn are regularly monitored to ensure compliance with the stipulated repayment terms. These financings are classified into one of the 5 risk classification categories: Standard, Special Mention, Substandard, Doubtful, and Loss – as stipulated by Central Bank of Oman regulations and guidelines. Muzn creates provision for non-performing debts promptly, as and when required in line with the conservative provisioning norms it has set for itself and arrives at the provisioning requirement both under financial reporting framework and CBO guidelines and maintains whichever provision is higher. In addition to the above, Muzn also makes a general loan loss provision on the standard portfolio equivalent to 2% of retail lending portfolio and 1% of corporate portfolio.

**A) Definition of default and cure**

The Window considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Window considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Window also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Window
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decreases in the underlying collateral value where the recovery of the financing is expected from the sale of the collateral
- A material decreases in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Window
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection. Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties

It is the Window's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

**B) Incorporation of forward-looking information**

The Window 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. Based on consideration of a variety of external actual and forecast information, the Window formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

Given the nature of the Window's exposures and availability of historical statistically reliable information, the Window derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Moody's for each rating category.

**C) Economic variable assumptions**

The method applied for determination of macroeconomic scenarios and their probabilities is a hybrid approach that combines deterministic forecast / modelling with analysis of stochastic distribution to get the alternative economic conditions and their probabilities.

The major assumptions and methodological choices can be summarised in a following set of steps:

1. Despite the fact that oil price was not chosen as an explanatory variable during statistical optimisation of variable selection, the business acumen as well as correlation analysis suggest that it is a major driving force in determination of GDP and real interest rate as defined by the World Bank (GDP deflator is highly affected by oil price as oil manufacturing is responsible for a vast portion of GDP volume in Oman).
2. The base scenario was created on the assumption of stabilisation of oil price at the level of 54 USD/barrel for Brent oil.
3. The alternative scenarios were constructed based on deviations from the base trajectory of oil price taking into account:
   a. historical volatility of changes in oil prices (28% standard deviation of annual relative price changes),
   b. size of the detachment equal to plus/minus 0,87 standard deviation from the base scenario as an approximate representation of 33,33% probability of alternative (adverse and favourable) scenarios,
   c. the time dynamics of the variable was based on assumption of normal distribution of annual changes of oil prices with some mean reverting characteristics and respective time scaling (standard deviation times square root of time) with the signs (-/+) in line with the character of the scenario (adverse / favourable).
4. GDP and real interest rate were forecasted deterministically based on their reciprocal dependencies and their relationship (with appropriate time lags) to oil price changes assuming mid-prices of Brent oil under given scenario as obtained through the process described in 3.

Basel II and III – Pillar III Report 2018

5. GDP per capita was predicted through regression to corresponding GDP changes as estimated for a given scenario and assumed lowering pace of population growth not dependent on the scenario in question.

**D) Corporate and small business lending**

For corporate and investment banking loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.
- The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Consumer lending and retail mortgages

Consumer lending comprises secured personal financing and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income / salary levels based on records of current accounts, personal indebtedness and expected interest repricing.
- Retail mortgages: GDP growth, unemployment rates, changes in personal income / salary levels based on records of current accounts, personal indebtedness and expected interest repricing.

**E) Exposure at default**

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 financing, the Window assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 financing that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Window determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Window's models.

**F) Loss given default**

For corporate and investment banking financial instruments, LGD values are assessed at least every twelve months by account managers and reviewed and approved by the Window's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Window segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics. Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the bank.

The Window estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI IFRS 9 segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

**G) Significant Increase in Credit Risk**

The Window continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Window assesses whether there has been a significant increase in credit risk since initial recognition.

The Window also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer / facility to the watch list, or the account becoming forborne. In certain cases, the Window may also consider that events set out below are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

a. Inadequate or unreliable financial or other information such as unavailability of audited financial statements within 120 days from end of accounting period.
b. Delay in documentation execution over 35 days from limit set up due to disputes with customers.
c. Borrower is subject to litigation by third parties that may have a significant impact on his financial position.
d. Frequent changes in key senior management personnel without acceptable successors or professional management.
e. Intra Group transfer of funds without underlying transactions beyond 50% of Tangible Net Worth.
f. Deferment / delay in the date for commencement of commercial operations by more than one year except in Government projects or delays are due to Government approvals.
g. Modifications of terms resulting in concessions granted to the borrower (after examining the cash flows of the borrower / financial position / ability to repay) including extension of moratorium, deferment of payment, waiver of covenants etc. This requirement shall be in conformity to the restructuring guidelines issued by CBO from time to time.
h. A fall of 25% or more in the turnover or in the EBIT as compared to the previous year except in the case of change in business model / one of material events.
i. A fall in Debt Service coverage ratio to below 1 except in cases which have acceptable external credit support.
j. Rating downgrade by 3 notches for ratings from R1 to R4 and 2 notches downgrade for R5 and R6.
k. Erosion in net worth by more than 20% compared to previous year coupled with increase in leverage by 1.5 times.

**H) Model risk management:**

The Window has utilised models in many of its financial and business activities from underwriting a credit facility to reporting expected loss under the IFRS9 accounting standards.

To manage the model risks, the Window has implemented the IFRS 9 Governance Framework (the Framework). The Framework is a bank wide policy and is applicable to all models of the Bank. According to the Framework, all internally or externally (vendor based) developed risk quantification models that directly affect the financial reporting on Expected Loss (EL) and Lifetime Expected Loss (LEL) require independent validation.

The Framework establishes a systematic approach to manage the development, validation, approval, implementation and on-going use of the models. It sets out an effective management structure with clearly defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international practices. Any major change to the Framework must be approved by the Board of Directors or the BRC.

The Window has a practice of doing independent model validation which provides recommendation to approve the use of the new risk quantification / valuation models. In addition to new model validation, it also evaluates the performance of existing models through an annual validation process. The independency of the team will serve as an effective second line of defense for the Window in terms of usage of models.

Basel II and III – Pillar III Report 2018

## Credit Risk (continued)

### (i) Total gross credit exposures over the period broken down by major types of credit exposure:

(RO'000)

| Sl No. | Type of Credit Exposure | Total Gross Exposure as at | |
|---|---|---|---|
| | | 31 December 2018 | 31 December 2017 |
| 1 | Deferred sales under Murabaha | 1,577 | 1,696 |
| 2 | Ijarah Muntahia Bittamleek | 85,291 | 86,596 |
| 3 | Diminishing Musharaka | 26,235 | 11,119 |
| 4 | Forward Ijarah | 4,721 | 4,703 |
| 5 | Service Ijarah | 11 | 0 |
| | Total | 117,835 | 104,114 |

### (ii) Geographic distribution of exposures by major types of credit exposure as at 31 December 2018:

As at 31 December 2018, all the credit exposures are within Oman only (2017: all exposures within Oman).

### (iii) Industry or counter party type distribution of exposures, broken down by major types of credit exposure as at 31 December 2018:

(RO'000)

| S. No | Economic Sector | Deferred sales under Murabaha | Ijarah Muntahiah Bittamleek | Diminishing Musharaka | Forward Ijarah | Service Ijarah | Total | Percentage composition | Off Balance sheet exposure** |
|---|---|---|---|---|---|---|---|---|---|
| 1 | Personal | 1,254 | 61,708 | 1,770 | 3,813 | 11 | 68,556 | 59% | 1,855 |
| 2 | Construction | 21 | 15,319 | 11,631 | 884 | - | 27,855 | 24% | 514 |
| 3 | Manufacturing | 78 | 1,313 | 10,029 | - | - | 11,420 | 10% | - |
| 4 | Trade | 81 | 38 | 342 | - | - | 461 | 0% | - |
| 5 | Services | 135 | 5,785 | 2,353 | - | - | 8,273 | 7% | - |
| 6 | Others | - | - | - | - | - | - | 0% | 176 |
| | Total | 1,569 | 84,163 | 26,125 | 4,697 | 11 | 116,565 | 100% | 2,544 |

***Off balance sheet exposure relates to commitments under standard business norms, letter of credits & guarantees.*

As at 31 December 2018, the assets were funded by IAH & Wakala Account and shareholders in the following ratio:

| | |
|---|---|
| IAH & Wakala Accounts | 77% |
| Shareholders | 23% |

### (iv) Residual contractual maturity as at 31 December 2018 of the whole financing portfolio, broken down by major types of credit exposure:

(RO'000)

| S. No | Time Band | Deferred sales under Murabaha | Ijarah Muntahiah Bittamleek | Diminishing Musharaka | Forward Ijarah | Service Ijarah | Total |
|---|---|---|---|---|---|---|---|
| 1 | Up to 1 month | 155 | 724 | 222 | 601 | - | 1,702 |
| 2 | 1 - 6 months | 394 | 5,118 | 2,367 | 287 | 1 | 8,167 |
| 3 | 6 - 12 months | 227 | 5,135 | 2,432 | 546 | 1 | 8,341 |
| 4 | 1 - 5 years | 607 | 16,437 | 11,854 | 3,263 | 4 | 32,165 |
| 5 | Over 5 years | 186 | 56,749 | 9,250 | - | 5 | 66,190 |
| | Total | 1,569 | 84,163 | 26,125 | 4,697 | 11 | 116,565 |

### (v) Movement of gross finance

(RO'000)

| Movement of Gross Finances during the year ended 31 December 2018 | | | | | |
|---|---|---|---|---|---|
| S. No | Details | Stage 1 | Stage 2 | Stage 3 | Total |
| 1 | Opening balance | 60,544 | 42,776 | 794 | 1,04,114 |
| 2 | Migration / changes (+ / -) | 7,226 | (8,614) | 1,389 | - |
| 3 | New Finances | 5,573 | 18,088 | 68 | 23,728 |
| 4 | Recovery of Financing | (10,008) | - | - | (10,008) |
| 5 | Closing balance | 63,333 | 52,250 | 2,251 | 117,835 |
| | Total ECL | 295 | 306 | 668 | 1,269 |

### (vi) Movement of Provisions and Reserve Profit

(RO'000)

| Particulars | 2018 | 2017 |
|---|---|---|
| Provision at beginning of the period | 1,333 | 1,333 |
| Charge / (Released) for the period | (168) | (33) |
| Reserve Profit for the period | 104 | 33 |
| Provision at end of the period | 1,269 | 1,333 |

Basel II and III – Pillar III Report 2018

## Credit Risk – Disclosures for portfolios subject to the standardized approach.

**Qualitative Disclosures:**

- The bank is following Moody's rating for both sovereign and interbank exposures and the balance is treated as unrated at 100% risk.
- With the approval of the CBO, the bank uses the discretion to treat Finances as unrated at risk weight of 100%, except housing finances which are risk weighted at 35% based on the requirements as stipulated in the guidelines issued by CBO.
- Similarly, with the approval of CBO, the Bank uses the discretion of the simple approach for recognising collaterals.

**Quantitative Disclosures:**

Gross exposure amount as at 31 December 2018, subject to the standardized approach is as below:

(RO'000)

| S. No | Product / Rating | Carrying 0% | Carrying 20% | Carrying 35% | Carrying 50% | Carrying 100% | Carrying 150% | Total |
|---|---|---|---|---|---|---|---|---|
| | **Rated** | | | | | | | |
| 1 | Sovereign | 15,839 | - | - | - | - | - | 15,839 |
| 2 | Banks | - | 5,335 | - | - | - | - | 5,335 |
| | **Unrated** | | | | | | | |
| 1 | Corporate | - | - | - | - | - | - | - |
| 2 | Retail | - | - | - | - | 1,272 | - | 1,272 |
| 3 | Claims secured by residential property | - | - | 44,842 | 176 | 23,815 | - | 68,834 |
| 4 | Claims secured by commercial property | - | - | - | - | 46,683 | - | 46,683 |
| 5 | Past due Financing | - | - | - | - | 1,582 | - | 1,582 |
| 6 | Other assets | 1,173 | - | - | - | 2,276 | - | 3,449 |
| 7 | Venture Capital & Private Equity Investments | - | - | - | - | - | - | - |
| 8 | Off-balance Sheet Items | - | - | - | - | - | - | - |
| | **Total Banking Book** | **17,012** | **5,335** | **44,842** | **176** | **75,629** | **-** | **142,994** |

## Credit Risk Mitigation

Credit risk mitigation refers to the use of a number of techniques, like collaterals and guarantees to mitigate credit risks that the Muzn is exposed to. Credit risk mitigates reduce the credit risk by allowing Muzn to protect against counterparty non-performance of credit contracts through collaterals, netting agreements and guarantees.

**Qualitative Disclosure:**

The Bank only considers Shari'a approved collaterals and guarantees to mitigate credit risk. Assets offered by the customer must meet the following criteria to be acceptable as collateral:

- Assets must be maintaining their value at the level prevalent at inception, until maturity of the facility approved;
- Such assets should be easily convertible into cash, if required;
- There should be a reasonable market for the assets; and
- Muzn should be able to enforce its right over the assets if necessary.

Currently Muzn undertakes ownership/joint ownership of assets provided by customers.

**Collateral Management:**

Muzn employs a range of policies and procedures to mitigate credit risk. The credit risk mitigates include collaterals like:

- Real estate
- Joint ownership

Collateral management is exercised for Muzn at the centralized level. A robust collateral management system is in place to mitigate any credit risk. The Bank has a strong credit administration process that ensures compliance with terms of approval, documentation and continuous review to ensure quality of credit and collaterals.

Securities obtained by way of legal mortgage over real estate to be valued at least once in 3 years or more frequently if situation warrants.

## Liquidity Risk

**Qualitative Disclosures:**

Liquidity may be defined as a Muzn's ability to ensure the availability of funds to meet all on-balance sheet and off-balance sheet commitments at a reasonable price. Liquidity Risk can in turn be defined as the risk to earnings and capital arising from a Muzn's potential inability to meet its liabilities when they become due.

Besides its funding sources, Muzn enjoys the support of its Parent Bank in meeting some of its liquidity needs.

The liquidity risk in Muzn is monitored through a regular reporting mechanism to the ALCO. In order to ensure that Muzn meets its financial obligations as and when they fall due, cash flow positions are closely monitored. Sufficient liquidity is required to be maintained by Banks not only for ensuring the continuation of operations, but also for the generation of earning assets and repayment of existing liabilities.

Liquidity ratios of Muzn (i.e. Liquid assets to total assets) are regularly monitored. The average ratio of liquid assets to total assets during the year for Muzn was 16.87% (as shown below). In addition, the cumulative gaps vis-à-vis cumulative liabilities prescribed by the Regulators / Internal Policies are monitored.

Muzn monitors its liquidity risk of funding related to current accounts and other equity with investment account holders on an individual basis as well as on an aggregate basis through cash flow and stock approach.

Treasury department of the Muzn window and the Asset Liability Committee (ALCO) controls and monitors the liquidity and ensures that the window is not exposed to undue liquidity risk and at the same time makes optimum use of its funds through Shari'a compliant financing and investment activities.

**Indicators of exposure to liquidity risk – short-term assets to short-term liabilities**

| Particulars | RO'000 |
|---|---|
| Short-term Assets | 36,674 |
| Short-term Liabilities | 102,451 |
| Short-term Assets to Liabilities | 35.80% |

**Indicators of exposure to liquidity risk - liquid assets ratio**

| Particulars | RO'000 |
|---|---|
| Liquid Assets | 23,803 |
| Total Assets | 141,131 |
| Short-term Liabilities | 102,451 |
| Total Liabilities | 129,362 |
| **Liquid Assets to Total Assets** | **16.87%** |
| **Liquid Assets to Short-term Liabilities** | **23.23%** |
| **Liquid Assets to Total Liabilities** | **18.40%** |

Basel II and III – Pillar III Report 2018

**Quantitative Disclosures:**

The maturity profile of the assets and liabilities in line with guidelines issued by Central Bank of Oman, at 31 December 2018 was as follows:

(RO'000)

| 31 December 2018 | Due on demand and up to 30 days | More than 1 month to 6 months | More than 6 months to 12 months | More than 1 year to 5 years | Over 5 years | Total |
|---|---|---|---|---|---|---|
| Cash and balances with Central Bank of Oman | 7,136 | 1,553 | 548 | 365 | 618 | 10,220 |
| Due from banks and financial institutions | 5,335 | - | - | - | - | 5,335 |
| Financial assets at amortized cost | 3,550 | - | - | 963 | 3,735 | 8,248 |
| Deferred sales under Murabaha | 155 | 394 | 227 | 607 | 186 | 1,569 |
| Ijarah Muntahiah Bittamleek – net | 724 | 5,118 | 5,135 | 16,437 | 56,749 | 84,163 |
| Diminishing Musharaka | 222 | 2,367 | 2,432 | 11,854 | 9,250 | 26,125 |
| Forward Ijarah | 601 | 287 | 546 | 3,263 | - | 4,697 |
| Service Ijarah | - | 1 | 1 | 4 | 5 | 11 |
| Property and equipment (net) | - | - | - | - | 421 | 421 |
| Other assets | 342 | - | - | - | - | 342 |
| **Total assets** | **18,065** | **9,720** | **8,889** | **33,493** | **70,964** | **141,131** |
| Current accounts | 1,189 | 2,081 | 1,190 | - | 1,485 | 5,945 |
| Wakala accounts | 11,452 | 51,819 | 17,634 | 4,607 | 18,004 | 103,516 |
| Due to banks and financial institutions | 10,060 | - | - | - | - | 10,060 |
| Other liabilities | 4,641 | - | - | - | - | 4,641 |
| Unrestricted investment account holders | 477 | 954 | 954 | 1,431 | 1,384 | 5,200 |
| Owner's equity | - | - | - | - | 11,769 | 11,769 |
| **Total liabilities and Unrestricted investment accountholders and owners' equity** | **27,819** | **54,854** | **19,778** | **6,038** | **32,642** | **141,131** |

## Market Risk

**Qualitative Disclosures:**

Market risk is the risk of a change in the actual or effective market value and earnings of a portfolio due to the adverse movements in market variables. The market variables inter-alia includes equity prices, bond price, commodity price and Foreign Exchange rates. The objective of Market Risk management is to facilitate business growth but operating at the optimal risk levels.

As at 31 December 2018, Muzn has minimal exposure to market risk as:

- Muzn does not have material exposure in currencies other than Omani Riyal;
- Muzn does not hold trading positions in equity;
- Muzn has no position in commodities.

Market Risk arises from fluctuations in profit rates. There are no trading positions in equities or derivatives.

Market Risk is managed based on Central Bank of Oman guidelines. The Muzn ALCO regularly monitors the portfolio of assets and liabilities in the banking book for any interest rate risks. Stress tests are also conducted periodically to analayze the impact of Bank and market specific stress factors crises on the earnings and capital of the Bank. The results are reviewed by ALCO, Management and Board Committee.

## Liquidity Risk

Liquidity Risk is defined as the ability to suitably sell the assets and meet obligations as they come due, is crucial to the ongoing viability of a banking organization. For this reason, the analysis of liquidity requires the bank management to not only measure the liquidity position of the Bank on an on-going basis but also examine how funding requirements are likely to evolve under various scenarios. Muzn manages its liquidity on a daily basis through its Treasury. In managing liquidity, Muzn takes into account the various regulatory requirements.

Muzn Treasury division ensures compliance with the liquidity ratios and the maturity gaps vis-à-vis the regulatory / in house caps / limits.

Market Risk and Muzn Treasury divisions will evaluate on an on-going basis the liquidity profile of the Bank, depending on the changing market conditions. Liquidity will be estimated under Bank specific crisis scenarios and Market crisis scenarios; with suitable assumptions built into each scenario.

## Operational Risk

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

The Bank follows basic indicator approach for determining operational risk.

The Capital charge for operational risk under Basic Indicator approach is calculated by taking the average of gross income multiplied by 15%, for each of the last three financial years, excluding years of negative or zero gross income. The gross income is Net profit income (+) other income (+) Provisions for unpaid profit (-) realized profit on sale of Available for Sale (AFS) investments (-) extraordinary / irregular items of income.

Capital Charge for Operational Risk under Basic Indicator Approach as per Basel II is RO (000s) 399.

The Risk weighted assets for operational risk as per Basel II is RO (000s) 4,988.

Insurance is another tool used by the bank as an operational risk mitigant. Insurance such as Bankers' Blanket Bond, Electronic and Computer Crimes, Professional Indemnity, incomplete transactions, etc., as obtained by the bank aim at protecting the bank from high severity risks by reducing the financial impact of the same.

In addition to the above and in order to keep control of operational incidences / losses the bank has set in place a special operational risk framework against which incidents / losses are being monitored regularly for possible breaches and appropriate mitigates are put in place.

## Rate of return risk

**Qualitative Disclosures:**

Rate of return risk refers to the possible impact on the net income of Muzn arising from the impact of changes in market rates and relevant benchmark rates on the return on assets and on the returns payable on funding. An increase in benchmark rates may result in IAH having expectation of a higher rate of return, while the returns on assets may be adjusting more slowly due to longer maturities, thereby affecting the net income of Muzn.

The profit distribution to Investment Accounts is based on profit sharing agreements. Therefore, Muzn is not subject to any significant profit rate risk. However, the profit sharing agreements will result in Displaced Commercial Risk (DCR) when Muzn' s results do not allow distribution of profits in line with market rates. To cater against DCR, Muzn creates a Profit Equalization Reserve.

Rate of return risk is managed by monitoring the sensitivity of the Bank's financial assets and liabilities to various standardized profit rate shocks. Standardised shocks include a 100 basis point and 200 basis point parallel shifts in yield curves that are considered on a monthly basis. The impact of these shocks is analysed in the context of its impact on Earnings and Economic Value. The impact is compared against internal limits which have been formulated in line with the Central Bank of Oman and Basel Committee guidelines. The analysis is regularly reviewed by the Management and Board Risk Committee.

**Quantitative Disclosures:**

The assumptions used to measure the sensitivity is parallel shift in interest rate by 200 basis points (bps) to measure the profit sensitivity of earnings and profit rate sensitivity of capital.

| As at December 2018 | 200 bps increase | 200 bps decrease |
|---|---|---|
| Earnings impact - RO'000s | 500 | (500) |

Basel II and III – Pillar III Report 2018

Muzn's profit sensitivity position, in line with guidelines issued by Central Bank of Oman, based on contractual re-pricing arrangements at 31 December 2018 was as follows:

(RO'000)

| 31 December 2018 | Effective average profit rate % | Due on demand and within 6 months | Due within 7 to 12 months | Due within 1 to 5 years | Due after 5 years | Non-profit bearing | Total |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Bank of Oman ("CBO") | N/A | - | - | - | - | 10,220 | 10,220 |
| Due from banks and financial institutions | 2.4% | 5,000 | - | - | - | 335 | 5,335 |
| Financial assets at amortized cost | 5.1% | - | - | 4,513 | 3,735 | - | 8,248 |
| Deferred sales under Murabaha | 5.1% | 549 | 227 | 607 | 186 | - | 1,569 |
| Ijarah Muntahia Bittamleek – net | 5.3% | 5,842 | 5,135 | 16,437 | 56,749 | - | 84,163 |
| Diminishing Musharaka | 5.8% | 2,589 | 2,432 | 11,854 | 9,250 | - | 26,125 |
| Forward Ijarah | N/A | - | - | - | - | 4,697 | 4,697 |
| Service Ijarah | 6.0% | 1 | 1 | 4 | 5 | - | 11 |
| Property and equipment – net | N/A | - | - | - | - | 421 | 421 |
| Other assets | N/A | - | - | - | - | 342 | 342 |
| **Total assets** | | 13,981 | 7,795 | 33,415 | 69,925 | 16,015 | 141,131 |
| Current accounts | N/A | - | - | - | - | 5,945 | 5,945 |
| Wakala accounts | 2.3% | 63,271 | 17,634 | 4,607 | 18,004 | - | 103,516 |
| Due to banks and financial institutions | 2.3% | 10,060 | - | - | - | - | 10,060 |
| Other liabilities | N/A | - | - | - | - | 4,641 | 4,641 |
| Unrestricted investment accountholders | 0.7% | 1,431 | 954 | 1,431 | 1,384 | - | 5,200 |
| Owners' equity | N/A | - | - | - | - | 11,769 | 11,769 |
| **Total liabilities and owners' equity** | | 74,762 | 18,588 | 6,038 | 19,388 | 22,355 | 141,131 |
| **On-balance sheet gap** | | (60,781) | (10,793) | 27,377 | 50,537 | (6,340) | - |
| **Cumulative profit sensitivity gap** | | (60,781) | (71,574) | (44,197) | 6,340 | - | - |

## Displaced commercial risk

Displaced commercial risk refers to the magnitude of risks that are transferred to the shareholders of Muzn in order to cushion the Investment Account Holders (IAH) from bearing some or all of the risks to which they are contractually exposed to in Mudaraba funding contracts. Muzn creates and manages both PER and Investment risk reserve to smoothen IAH returns. Further, Muzn also adjusts its Mudarib share in order to smoothen returns of IAH.

**Qualitative Disclosures:**

- The Bank has set up prudential reserve account to minimize the adverse impact of income smoothing for PSIA on its shareholders' returns and to meet potential but unexpected losses that would be borne by the IAH on investments financed by PSIA, namely:
- Profit Equalization Reserve (PER)

  PER comprises amounts appropriated out of the gross income from the Mudaraba to be available for smoothing returns paid to the IAH and the shareholders, and consists of a PSIA portion and a shareholders' portion;
- Investment Risk Reserve (IRR)

  IRR comprises amounts appropriated out of the income of IAH after deduction of the Mudarib share of income, to meet any future losses on the investments financed by the PSIA.

An analysis of distribution during the year to IAH by Muzn is as follows:

| Particulars | Amount RO'000 |
|---|---|
| Total profits available for distribution | 5,634 |
| **Profit sharing** | |
| - Muzn's share as fund provider | 2,070 |
| - IAH | 3,433 |
| | |
| Profits for IAH before smoothening | 3,433 |
| **Smoothening:** | |
| - PER | (56) |
| - IRR | (25) |
| Profits paid out to IAH after smoothening | 3,352 |

- During the period the Bank utilized OMR Nil (FY2017: Nil) from PER for the purpose of enhancing the returns to depositors.
- The Bank is taking all the Risk Weighted Assets funded by IAH for the purpose of arriving at Total Risk Weighted Assets and capital requirement is calculated accordingly.

**Qualitative Disclosures:**

Historical Rate of Return of IAH:

| Historical Rate of Return of unrestricted Investment Accountholder: | 2018 RO '000 | 2017 RO '000 | 2016 RO '000 | 2015 RO '000 | 2014 RO '000 |
|---|---|---|---|---|---|
| Profits available for distribution | 5,634 | 4,512 | 3,674 | 1,349 | 405 |
| Profit Distributed | 3,352 | 3,061 | 1,536 | 591 | 269 |
| | | | | | |
| Funds Invested | 116,565 | 102,781 | 105,099 | 96,787 | 67,543 |
| Rate as %age of fund invested | 2.88% | 2.98% | 1.46% | 0.61% | 0.40% |

Five years comparison of historical profit rates for unrestricted IAH.

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|---|---|---|---|---|
| Savings Account (Mudarabah) | 0.77% | 0.70% | 0.73% | 0.79% | 0.90% |
| Flexi Wakala | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% |
| Flexi Wakala - Elite | 2.25% | 2.25% | 2.25% | 2.25% | - |
| Flexi Wakala - Premium | 1.75% | 1.75% | - | - | - |
| Wakala - Upto 6 Months | 0.10% - 0.25% | 0.10% - 0.25% | 0.10% - 0.25% | 0.10% - 0.25% | 0.10% - 0.25% |
| Wakala - > 6 Months to 1 Year | 0.40% - 0.75% | 0.40% - 0.75% | 0.40% - 0.75% | 0.40% - 0.55% | 0.35% - 0.50% |
| Wakala - > 1 Year to 3 Years | 1.75% - 2.50% | 1.75% - 2.50% | 1.75% - 2.50% | 0.75% - 1.75% | 0.70% - 1.60% |
| Wakala - > 3 Years | 3.00% - 3.50% | 3.00% - 3.50% | 3.00% - 3.50% | 2.00% - 2.25% | 1.80% - 2.00% |
| Government Flexi Wakala | 1.00% | 1.00% | 0.50% | 0.50% | 0.50% |

Basel II and III – Pillar III Report 2018

## Contract Specific Risks

The Credit Risk Appetite document of Muzn has provided limits for the purpose of financing, it is defined within the purpose of financing are the various Shari'a compliant financing contracts that can be used. The risk weighting requirement for each of the Shari'a compliant financing contracts, based on the risk profile of the customer as provided in the IBRF is taken into account for the purposes of computing the Capital Adequacy Ratio of Muzn.

**Qualitative Disclosures:**

Credit risk weighted assets by type of financing contracts is as follows:

| Financing Contracts | Risk Weighted Assets Amount '000 |
|---|---|
| Deferred sales receivable under Murabaha | 1,576 |
| Ijarah Muntahia Bittamleek | 58,833 |
| Diminishing Musharaka | 25,092 |
| Forward Ijarah | 2,506 |
| Service Ijarah | 11 |
| Letter of Guarantee | 88 |
| Letter of Credit | - |
| Total RWA of Financing Contracts | 88,106 |

### General Governance Disclosures

The CMA code of Corporate Governance for Public Listed Companies and the CBO guidelines as per IBRF Corporate Governance and Banking and Financial Institutions are the principal codes and drivers of Corporate Governance practices in the Sultanate of Oman. Muzn complies with all their provisions.

The following disclosure summarizes the disclosures of related party:

(RO'000)

| Deposits and other accounts | 2018 | 2017 |
|---|---|---|
| Directors, Shari'a Supervisors and shareholders holding less than 10% interest in Muzn | 8,548 | 6,940 |
| **Financings** | | |
| Directors, Shari'a Supervisors and shareholders holding less than 10% interest in Muzn | 104 | 120 |

(RO'000)

| Remuneration paid to Directors & Shari'a Supervisors | 2018 | 2017 |
|---|---|---|
| **Chairman** | | |
| – remuneration proposed | 8 | 8 |
| – sitting fees paid | 3 | 3 |
| – other expenses paid | 3 | 3 |
| **Other Directors** | | |
| – remuneration proposed | 17 | 19 |
| – sitting fees paid | 11 | 12 |
| – other expenses paid | 6 | 8 |
| Management fee payable to conventional banking | 60 | 60 |

Muzn maintains a formal procedure on handling of customer complaints. Complaints related to Muzn are dealt with by the conventional banking call center equipped with the required resources to respond to customer calls in a professional manner. The complaint management team of the Conventional Bank takes active part in resolution of customers' complaint and considers customers feedback on products and services. All complaints are logged and investigated by persons not directly related to the subject matter of the complaint.



## Shari'a Governance Disclosures

### Shari'a Supervisory Board (SSB)

Muzn's independent Shari'a Supervisory Board is an external Shari'a Committee comprising of independent and well renowned Shari'a Scholars who guide and ensure that the operations, services and products offered by Muzn comply with the principles of Shari'a.

In case SSB rules any earnings Shari'a non-compliant, such income is diverted to a charity account and disbursed to charitable organization. Income generated from late payment charges (whereby client undertakes to donate to charity a certain amount in case of delay in installment payments) and whenever a transaction which is treated as Shari'a non-Compliant by Shari'a Audit Unit and endorsed by SSB, the income from such shari'a non-compliant account becomes part of charity Account.

The Internal Shari'a reviewer performs functions based on the shari'a guidelines provided by CBO in the IBRF, Shari'a rulings and resolutions issued by SSB. Shari'a audit includes continuous audit for transactions of all departments. Its observations and findings are reported in the Shari'a audit report to SSB which is also conveyed and discussed with management, with documentation of management responses in addition to recommending action plan for each observation.

As per IBRF, Islamic banks are required to apply Accounting standards (Only and not the Shari'a Standards) issued by AAOIFI and abide by the comprehensive IBRF regulatory framework and guidelines.

Muzn's Shari'a Supervisory Board consists of following members namely:

**Sheikh Dr. Mohamed Bin Ali Elgari** is a Professor of Islamic Economics at King Abdulaziz University, Saudi Arabia. He is an Expert at the Islamic Jurisprudence Academy of the Organization of Islamic Cooperation (OIC) and the Islamic Jurisprudence Academy of the Islamic World League. Sheikh Elgari is also a member of the Shari'a Council of Accounting and Auditing Organization for Islamic Financial Institutions (AAOFI), Chairman Shari'a Supervisory Board of Muzn Islamic Banking Services and Shari'a Board Member of several reputable Islamic Banks and Takaful Companies across the globe.

**Sheikh Datuk Dr. Mohamed Daud Bakar** is a Malaysian Shari'a Scholar and Chairman of the Central Shari'a Advisory Council of the Central Bank of Malaysia and Securities Commission of Malaysia. Sheikh Bakar's area of specialization includes Islamic Legal Theory, Islamic Banking and Finance and Islamic Law of Zakah. Datuk Dr. Bakar has published more than 30 articles in academic journals while also being a member of several Shari'a Boards for Banks and Islamic financial institutions worldwide.

**Sheikh Saleh Al Kharusi** is a Director of the Notary Public Office Ministry of Justice and a part-time lecturer of Shari'a sciences. Sheikh Saleh has bachelor's degree in Shari'a from the Institute of Shari'a Sciences in the Sultanate of Oman and a Master's Degree in Financial Transaction from Sultan Qaboos University.

**Dr. Khalid Said Al Amri,** an Assistant professor at Sultan Qaboos University. Dr. Al Amri serves as an advisor to the board of director at Al Madina Takaful and a member in the Audit Committee. He has done extensive research in the area of finance, Takaful insurance, and financial risk management. His research interests focus on finance, corporate governance, Takaful insurance, and, Risk Management. He also serves as an ad hoc referee for international academic journals. He has published in a number of internationally refereed journals and delivered presentations at international renowned conferences. He has been awarded a best paper award in Western Risk and Insurance in USA. Dr. Al Amri is a member of American Risk and Insurance Association (ARIA). He is also a Certified Shari'a Advisor and Auditor from AAOIFI - Accounting and Auditing Organization for Islamic Financial Institutions.

**H.H Sayyid Dr. Adham Turki Al Said,** is an Assistant Professor of Economics at Sultan Qaboos University in Oman. Dr. Adham is a Chairman of Board of Trustees, Scientific College of Design. He is also a member in several government and private organizations such as Partner, The Firm for Business and Economic Consulting and he provided a proposal on SME to Shura Council in 2014. Dr. Adham has a Ph.D. in Economics from University of Western Australia, Australia – 2011.

There were a total of four SSB meetings held in 2018. Date of the meetings and attendance of each SSB Member is follows:

| Name of the Board Member | Date of Meeting and attendance | | | |
|---|---|---|---|---|
| | 20/03/2018 | 11/07/2018 | 11/10/2018 | 16/12/2018 |
| Sheikh Dr. Mohamed Bin Ali Elgari – Chairman | √ | √ | √ | √ |
| Sheikh Datuk Dr. Mohammed Daud Bakar | √ | √ | √ | √ |
| Sheikh Saleh Al Kharusi | √ | √ | √ | √ |
| H.H Sayyid Dr. Adham Al Said – Non-Voting Member | √ | √ | √ | √ |
| Dr. Khalid Said Al Amri – Non-Voting Member* | √ | √ | - | - |

Basel II and III – Pillar III Report 2018

**Remuneration for Shari'a Supervisory Board Members in 2018:**

Total Remuneration paid to the five Scholars for the year 2018 was OMR 38,885.000. The breakup is as follows:

| Name of the Board Member | Total Fees (RO) |
|---|---|
| Sheikh Dr. Mohamed Bin Ali Elgari | 10,780.000 |
| Sheikh Datuk Dr. Mohammed Daud Bakar | 8,855.000 |
| Sheikh Saleh Al Kharusi | 8,855.000 |
| H.H Sayyid Dr. Adham Al Said – Non-Voting Member | 6,930.000 |
| Dr. Khalid Said Al Amri – Non-Voting Member | 3,465.000 |

### Shari'a compliance key controls

Shari'a compliance is ensured in day to day business of Muzn through the following key controls:

- All the products being offered by Muzn are approved by the SSB;
- All investments made by Muzn are approved by SSB;
- The Fatawa approving such products are available on the website of Muzn;
- The responsibility of payment of zakat is on individual shareholders and investment account holders;
- There has been no non-compliance with Shari'a rules and regulations during the year;
- Muzn has in place a Shari'a Compliance Unit (SCU) which facilitates the management in ensuring compliance with Shari'a (as manifested by the guidelines and Fatawa issued by the SSB) and Islamic banking stipulations of the Central Bank on a day to day basis in all its business activities, operations and transactions. This is achieved through review and approval of the contracts, agreements, policies, procedures, products, process flows, transactions, reports (profit distribution calculations), etc;
- Templates of agreements used by Muzn are approved by SSB;
- Islamic banking knowledge and experience is considered to be a compulsory requirement for hiring of staff handling core Muzn functions; staff has been provided training throughout the year on Shari'a matters;

### Disclosure of the nature, size and number of violations of Shari'a compliance during the year:

There is no violation to SSB's Shari'a ruling and AAOIFI Shari'a standard have been found during the year.

### Disclosure of annual Zakah contributions of the Licensee, where relevant, according to constitution, general assembly or national requirements or as required by the respective SSB

SSB issues its Shari'a compliance certificate where it identifies that Shari'a compliance has been observed in The Bank's transactions and contracts, and in case of any violation, the observation is listed in the report. In addition, and as per Management decision, SSB certificate also stipulates that Zakat calculation and payment is the responsibility of the shareholders.

### Social service and customer education

Muzn Islamic Banking is continuously providing education to customers and engaged in social service activities. In past couple of years, Muzn held Shari'a forums in Salalah, Sur and Muscat regions under its SSB to create awareness about local community. The website of Muzn has sections for brief detail of products and FAQs on Islamic Banking for imparting knowledge regarding Islamic Banking. Muzn's staff are well trained in Islamic banking and they educate customers about Islamic banking and about Shari'a Compliant products in detail.

Muzn Islamic Banking as part of National Bank of Oman distributes food hampers to the poor and needy people in the holy month of Ramadan. A team of volunteers including the senior management team delivered several food hampers to low income families across the Muscat Governorate to inaugurate this initiative.

### BASEL III – Transition Disclosure:

Further to the Guidelines on composition of capital disclosure requirements (CP1 & CP2) issued by Central Bank of Oman, the following are the mandatory disclosures for the year ended 31 December 2018.

**Basel III common disclosure template to be used during the transition of regulatory adjustments (i.e. from 1 January 2013 to 1 January 2018) (RO '000)**

| | Amounts Subject to Pre-Basel III Treatment |
|---|---|
| **Common Equity Tier 1 capital: instruments and reserves** | |
| Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus | 13,500 |
| Retained earnings | (1,731) |
| Accumulated other comprehensive income (and other reserves) | |
| Public sector capital injections grandfathered until 1 January 2018 | - |
| Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | - |
| **Common Equity Tier 1 capital before regulatory adjustments** | **11,769** |
| **Common Equity Tier 1 capital: regulatory adjustments** | |
| Deferred tax assets arising from temporary differences (net of related tax liability) | - |
| National specific regulatory adjustments of which: Shortfall in MCR of Islamic Banking window and foreign branches of the bank | - |
| Total regulatory adjustments to Common equity Tier 1 | |
| **Common Equity Tier 1 capital (CET1)** | **11,769** |
| **Additional Tier 1 capital: instruments** - NIL | |
| **Additional Tier 1 capital: regulatory adjustments** | |
| **Total regulatory adjustments to Additional Tier 1 capital** | - |
| **Additional Tier 1 capital (AT1)** | |
| **Tier 1 capital (T1 = CET1 + AT1)** | **11,769** |
| **Tier 2 capital: instruments and provisions** | |
| Directly issued qualifying Tier 2 instruments plus related stock surplus | - |
| Directly issued capital instruments subject to phase out from Tier 2 | - |
| Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) | - |
| Of which: instruments issued by subsidiaries subject to phase out | - |
| General Provisions | 601 |
| **Tier 2 capital before regulatory adjustments** | 601 |
| **Tier 2 capital: regulatory adjustments** | |
| National specific regulatory adjustments | - |
| Regulatory adjustments applied to Tier 2 in respect of amounts subject to Pre-Basel III treatment. | - |
| Of which: Cumulative fair value gains or losses on available for sale instruments | - |
| **Total regulatory adjustments to Tier 2 capital** | - |
| **Tier 2 capital (T2)** | **601** |
| **Total capital (TC = T1 + T2)** | **12,370** |
| **Total risk weighted assets** | **97,471** |

Basel II and III – Pillar III Report 2018

| | Amounts Subject To Pre-Basel III Treatment |
|---|---|
| Of which: Credit risk weighted assets | 92,479 |
| Of which: Market risk weighted assets | 4 |
| Of which: Operational risk weighted assets | 4,988 |
| **Capital Ratios** | |
| Common Equity Tier 1 (as a percentage of risk weighted assets) | 12.1 |
| Tier 1 (as a percentage of risk weighted assets) | 12.1 |
| Total capital (as a percentage of risk weighted assets) | 12.7 |
| Institution specific buffer requirement (minimum CET1 requirement plus capital conservation buffer plus countercyclical buffer requirements plus G-SIB / D-SIB buffer requirement expressed as a percentage of risk weighted assets) | |
| Of which: capital conservation buffer requirement | |
| Of which: bank specific countercyclical buffer requirement | |
| Of which: D-SIB/G-SIB buffer requirement | |
| Common Equity Tier 1 available to meet buffers (as a percentage of risk weighted assets) | |
| **National minima (if different from Basel III)** | |
| National Common Equity Tier 1 minimum ratio (if different from Basel 3 minimum) | 7.00 |
| National Tier 1 minimum ratio (if different from Basel 3 minimum) | 9.00 |
| National total capital minimum ratio (if different from Basel 3 minimum) | 11.00 |
| **Total Investment account holders** | |
| Amount of investment account holders funds | 4,772 |
| Profit equalization reserve | 310 |
| Investment risk reserve | 118 |
| **Total Investment account holders** | **5,200** |

**Prepared under the Guidelines on composition of capital disclosure requirements**

Balance sheet as in published financial statements RO'000s

| | Balance sheet as in published financial statements 31-Dec-18 |
|---|---|
| **Assets** | |
| Cash and balances with Central Bank of Oman | 10,220 |
| Certificates of deposit | - |
| Due from banks | 5,335 |
| Financing to banks | - |
| Financing to Customers | 116,565 |
| Investments | 8,248 |
| Property and equipment | 421 |
| Deferred tax assets | - |
| Other assets | 342 |
| **Total assets** | **141,131** |
| **Liabilities** | |
| Due to banks | 10,060 |
| Customer deposits | 114,661 |
| Euro medium term notes | - |
| Other liabilities | 4,641 |
| Subordinated bonds | - |
| **Total liabilities** | **129,362** |
| Shareholders' Equity | |
| Paid-upshare capital | 13,500 |
| Share premium | - |
| Legal reserve | - |
| General reserve | - |
| Retained earnings | (1,731) |
| Other reserves | - |
| Cumulative changes in fair value of investments | - |
| Subordinated debt reserve | - |
| Tier 1 perpetual bond | - |
| **Total shareholders' equity** | **11,769** |
| **Total liability and shareholders' funds** | **141,131** |

Basel II and III – Pillar III Report 2018

Balance sheet as in published financial statements expanded RO'000s

| | Balance sheet as in published financial statements 31-Dec-18 | Reference |
|---|---|---|
| **Assets** | | |
| Cash and balances with Central Bank of Oman | 10,220 | |
| Certificates of deposit | - | |
| Balance with banks and money at call and short notice | 5,335 | |
| Investments | 8,248 | |
| **Financing of which:** | | |
| Financing to Banks - Gross | - | |
| General Provisions considered for Tier 2 | - | |
| **Net Financing to banks** | - | |
| Financing to Customers - Gross | 117,835 | |
| ECL Stage 1 | (295) | A1 |
| ECL Stage 2 | (306) | A1 |
| ECL Stage 3 | (669) | |
| **Net Financing to customers** | **116,565** | |
| Fixed assets | 421 | |
| Other assets of which: | 342 | |
| Deferred tax assets | - | |
| Amount considered for CET1 | | |
| Current year allocation - not eligible | - | |
| **Total Assets** | **141,131** | |
| **Capital & Liabilities** | | |
| Paid-up Capital | - | |
| Of which: | | |
| Amount eligible for CET1 | 13,500 | C1 |
| Amount eligible for AT1 | - | |
| Reverses and Surplus | (1,731) | |
| Of which: Amount eligible for CET1 | | C2 |
| Retained earnings carried forward | (1,731) | |
| Profit for current year not eligible | - | |
| Legal reserve | - | |
| General reserve | - | |
| Subordinated debt reserve | - | |
| Proposed Stock Dividend | - | |
| **Total Amount eligible for CET1** | - | |
| Tier 1 perpetual bond | - | |
| Proposed Cash Dividend | - | |
| Cumulative changes in fair value of investments | - | |
| Amount eligible for Tier 2 | - | |
| Revaluation reserve | - | |
| **Total Capital** | **11,769** | |
| Deposits of which: | - | |
| Deposits from banks | 10,060 | |
| Customer deposits | 114,661 | |
| Euro medium term notes | - | |
| Other deposits (Sub-debt) | - | |
| Other liabilities & provisions of which: | 4,641 | |
| **Total** | **141,131** | |

Basel III common disclosure template to be used during the transition of regulatory adjustments (RO '000)

| | Component of regulatory capital reported by bank | Source based on reference numbers/letters of the balance sheet under the regulatory scope of consolidation from step 2 |
|---|---|---|
| Common Equity Tier 1 capital: instruments and reserves | | |
| Directly issued qualifying common share capital (and equivalent for non-joint stock companies) plus related stock surplus | 13,500 | |
| Retained earnings | (1,731) | C1 |
| Accumulated other comprehensive income (and other reserves) | - | |
| Public sector capital injections grandfathered until 1 January 2018 | - | C2 |
| Common share capital issued by subsidiaries and held by third parties (amount allowed in group CET1) | - | |
| **Common Equity Tier 1 Capital before regulatory adjustments** | 11,769 | |
| **Common Equity Tier 1 Capital: regulatory adjustments** | | |
| Deferred tax assets arising from temporary differences (net of related tax liability) | - | |
| **Total regulatory adjustments to Common equity Tier 1** | - | |
| **Common Equity Tier 1 Capital (CET1)** | 11,769 | |
| **Additional Tier 1 Capital: instruments (Tier 1 Perpetual Bond)** | - | |
| **Additional Tier 1 Capital: regulatory adjustments - Nil** | | |
| **Tier 1 Capital (T1 = CET1 + AT1)** | 11,769 | |
| **Tier 2 Capital: instruments and provisions** | | |
| Directly issued qualifying Tier 2 instruments plus related stock surplus | - | |
| Directly issued capital instruments subject to phase out from Tier 2 | - | |
| Tier 2 instruments (and CET1 and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties (amount allowed in group Tier 2) | - | |
| Of which: instruments issued by subsidiaries subject to phase out | - | |
| General provisions | 601 | A1 |
| Cumulative fair value gains or losses on available for sale instruments | | |
| **Tier 2 Capital before regulatory adjustments** | 601 | |
| Tier 2 Capital: regulatory adjustments | | |
| National specific regulatory adjustments | - | |
| Regulatory adjustments applied to Tier 2 in respect of amounts subject to Pre-Basel III treatment. | - | |
| Of which: Cumulative fair value gains or losses on available for sale instruments | - | |
| **Total regulatory adjustments to Tier 2 Capital** | - | |
| **Tier 2 Capital (T2)** | **601** | |
| **Total Capital (TC = T1 + T2)** | **12,370** | |

**Disclosure template for main features of all regulatory capital instruments**

1. **Common Equity**

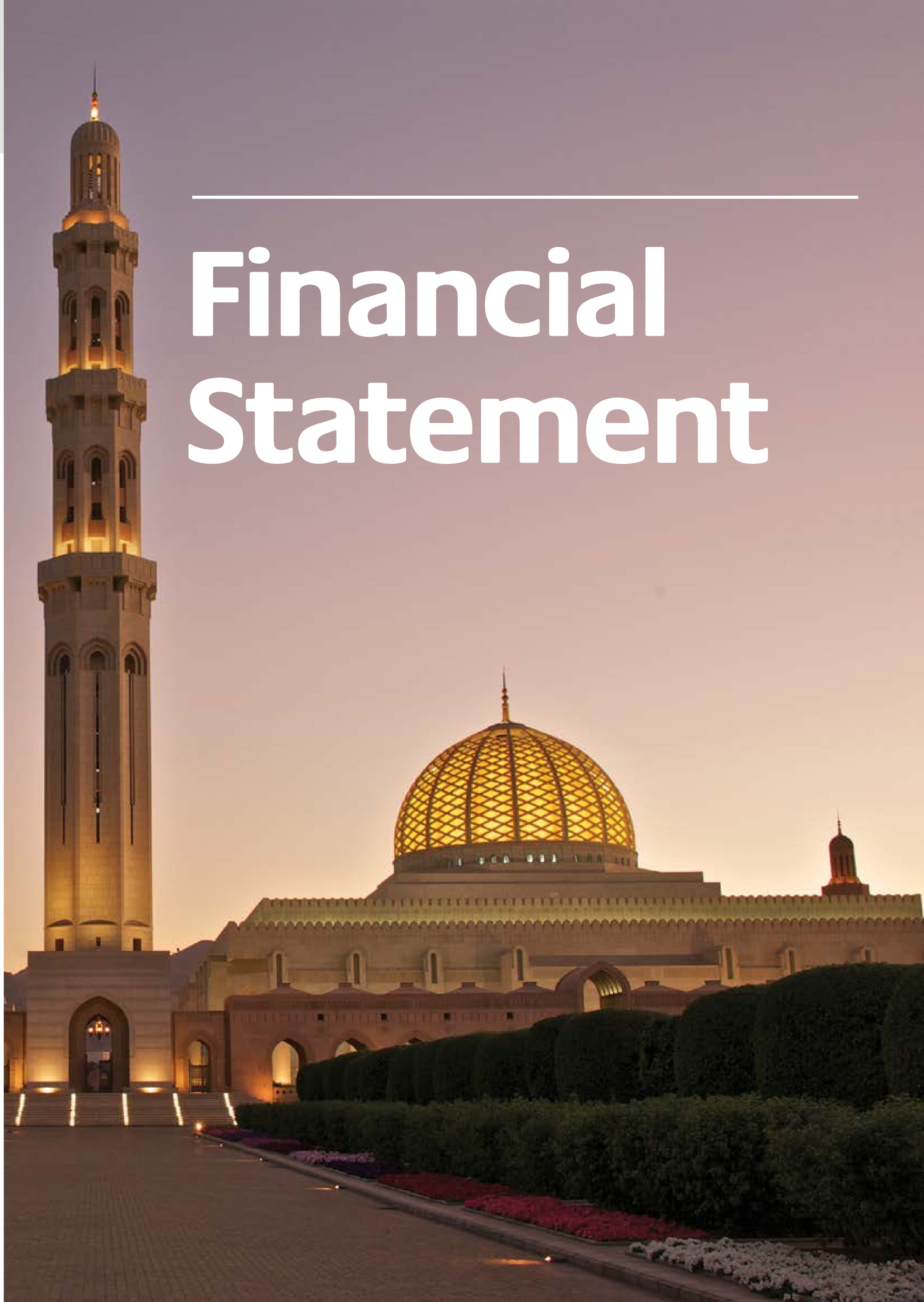
   Common equity comprises of assigned capital amounting to RO 13,500,000 transferred from National Bank of Oman SAOG.

2. **All other regulatory capital instruments - Nil**

   This report on Basel II & III disclosures set out from pages no 1 to 25 was authorized for issue on 28th January 2018.

**Rawan bint Ahmed Al Said**
Chairperson





# Financial Statement

Building a better working world

Ernst & Young LLC
P.O. Box 1750, Ruwi 112
5th Floor, Landmark Building
Opposite Al Ameen Mosque
Bowsher, Muscat
Sultanate of Oman

Tel: +968 22 504 559
Fax: +968 22 060 810
muscat@om.ey.com
ey.com/mena
C.R. No. 1224013
PR No. HMH/15/2015; HMA/9/2015

**INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF NATIONAL BANK OF OMAN SAOG (the "Bank")**

**Report on the financial statements**

We have audited the accompanying statement of financial position of Muzn Islamic banking - Window of National Bank of Oman (the "Islamic Window) as of 31 December 2018, and the related statements of income, changes in owners' equity, cash flows and sources and uses of charity fund for the year then ended, and a summary of significant accounting policies and other explanatory information. These financial statements and the Bank's undertaking to operate its Islamic Window in accordance with Islamic Shari'a Rules and Principles as determined by the Shari'a Supervisory Board are the responsibility of the Bank's Board of Directors. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Auditing Standards for Islamic Financial Institutions issued by the Accounting and Auditing Organisation for Islamic Financial Institutions ("AAOIFI"). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

**Opinion**

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Islamic Window as of 31 December 2018, the results of its operations, changes in owners' equity, cash flows and sources and uses of charity fund for the year then ended in accordance with the Shari'a Rules and Principles as determined by the Shari'a Supervisory Board of the Islamic Window of the Bank and the Financial Accounting Standards issued by AAOIFI.

Ernst & Young LLC

Muscat
10 March 2019

ارنست ويونغ ش م م
س ت: ١٢٢٤٠١٣
ص.ب: ١٧٥٠ روي - ١١٢، سلطنة عمان
ERNST & YOUNG LLC
C.R. No. 1224013
P.O. Box 1750 - P.C. 112, Sultanate of Oman

A member firm of Ernst & Young Global Limited



## Statement of Financial Position
### As at 31 December 2018

| | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|
| **Assets** | | | |
| Cash and balances with Central Bank of Oman | 5 | **10,220** | 5,269 |
| Due from banks and financial institutions | 6 | **5,335** | 19,932 |
| Financial assets at amortised cost | 7 | **8,248** | 5,476 |
| Deferred sales under Murabaha | 8 | **1,569** | 1,665 |
| Ijarah Muntahia Bittamleek - net | 9 | **84,163** | 85,452 |
| Diminishing Musharaka | 10 | **26,125** | 11,008 |
| Forward Ijarah | 11 | **4,697** | 4,656 |
| Service Ijarah | 12 | **11** | - |
| Property and equipment - net | 13 | **421** | 599 |
| Other assets | 14 | **342** | 247 |
| **Total assets** | | **141,131** | 134,304 |
| **Liabilities, Unrestricted Investment Account Holders and Owners' Equity** | | | |
| **Liabilities** | | | |
| Current accounts | | **5,945** | 5,276 |
| Wakala accounts | 15 | **103,516** | 109,509 |
| Due to banks and financial institutions | 16 | **10,060** | - |
| Other liabilities | 17 | **4,641** | 3,481 |
| **Total Liabilities** | | **124,162** | 118,266 |
| Equity of unrestricted investment accountholders | 19 | **5,200** | 4,947 |
| **Owners' Equity** | | | |
| Assigned capital | 20 | **13,500** | 13,500 |
| Accumulated losses | | **(1,731)** | (2,409) |
| **Total Owners' Equity** | | **11,769** | 11,091 |
| **Total liabilities, unrestricted investment account holders and owners' equity** | | **141,131** | **134,304** |

*The financial statements were approved by the Board of Directors on 29 January 2019*

Chairperson

Acting Chief Executive Officer

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

# Statement of Comprehensive Income
For the year ended 31 December 2018

| | Notes | 2018 RO'000 | 2017 RO'000 |
|---|---|---|---|
| **Income** | | | |
| Deferred sales under Murabaha | 21 | **82** | 86 |
| Ijarah Muntahia Bittamleek | 22 | **4,521** | 4,125 |
| Diminishing Musharaka | 23 | **793** | 661 |
| Inter-Bank Wakala | | **342** | 141 |
| Investment income | | **373** | 227 |
| **Income from jointly financed assets** | | **6,111** | 5,240 |
| **Less:** | | | |
| Return on unrestricted investment accountholders | 24 | **(33)** | (33) |
| Return on Wakala accountholders | 25 | **(3,319)** | (3,028) |
| Return on Inter-bank Wakala Acceptence | | **(131)** | - |
| Profit equalisation reserve | | **(56)** | (56) |
| Investment risk reserve | | **(25)** | (25) |
| | | **(3,564)** | (3,142) |
| **Muzn's Share in Income from Investment as Mudarib and Rabul Maal** | | **2,547** | 2,098 |
| Revenue from banking services | | **285** | 184 |
| Foreign exchange (losses) gains – net | | **47** | 38 |
| **Total operating revenue** | | **2,879** | 2,320 |
| General and administrative expenses | 26 | **(2,085)** | (2,135) |
| Provisions for credit loss | 18 | **(236)** | (9) |
| Recoveries and release from provisions of credit loss | 18 | **15** | 42 |
| Depreciation | 13 | **(191)** | (275) |
| **Total operating expenses** | | **(2,497)** | (2,377) |
| **Profit/(loss) for the year** | | **382** | (57) |

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

# Statement of Changes in Equity
For the year ended 31 December 2018

| | Share capital RO'000 | Accumulated losses RO'000 | Total RO'000 |
|---|---|---|---|
| Balance at 1 January 2018 | 13,500 | (2,409) | 11,091 |
| Impact of adopting IFRS 9 (note 3.25)* | - | 296 | 296 |
| Restated opening balance under IFRS 9 | 13,500 | (2,113) | 11,387 |
| Profit for the year | - | 382 | 382 |
| **Balance at 31 December 2018** | **13,500** | **(1,731)** | **11,769** |
| Balance at 1 January 2017 | 13,500 | (2,352) | 11,148 |
| Loss for the year | - | (57) | (57) |
| Balance at 31 December 2017 | 13,500 | (2,409) | 11,091 |

**The related difference (net of tax) between the existing financing loss impairment computed in accordance with the requirements of AAOIFI and CBO guidelines and the impairment allowance computed under IFRS 9, has not transferred to a financing loss impairment reserve from accumulated losses as of 1 January 2018 and 31 December 2018, as the Window is not a separate legal entity and the requirement is assessed at the overall Bank level.*

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

# Statement of Cash Flow
For the year ended 31 December 2018

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| **Operating Activities** | | |
| Net profit for the year | **382** | (57) |
| **Adjustments for:** | | |
| Depreciation | **191** | 275 |
| Provisions for credit loss | **236** | 9 |
| Recoveries and release from provisions of credit loss | **(15)** | (42) |
| Profit equalisation reserve | **56** | 56 |
| Investment risk reserve | **25** | 25 |
| **Operating cash flow before changes in operating assets and liabilities** | **875** | 266 |
| Changes in operating assets and liabilities: | | |
| Deferred sales under Murabaha | **95** | 66 |
| Ijarah Muntahia Bittamleek assets | **1,288** | (1,441) |
| Diminishing Musharaka assets | **(15,118)** | 1,075 |
| Forward Ijarah assets | **(42)** | 2,571 |
| Service Ijarah assets | **(12)** | - |
| Other assets | **(96)** | 13 |
| Customer's current accounts | **669** | 406 |
| Customer's Wakala accounts | **(5,993)** | (4,609) |
| Other liabilities | **1,160** | 1,304 |
| **Net cash used in operating activities** | **(17,174)** | (349) |
| **Investing Activities** | | |
| Purchase of property and equipment | **(13)** | (486) |
| Investment in Financial assets at amortised cost | **(2,772)** | (1,513) |
| **Net cash used in investing activities** | **(2,785** | (1,999) |
| **Financing Activities** | | |
| Movement in unrestricted investment accountholders | **253** | 682 |
| Assigned capital | - | - |
| **Net cash from financing activities** | **253** | 682 |
| **Decrease in cash and cash equivalents** | **(19,706)** | (1,666) |
| Cash and cash equivalents at the beginning of the year | **25,201** | 26,867 |
| **Cash and cash equivalents at the end of the year** | **5,495** | 25,201 |
| **Representing:** | | |
| Cash and balances with Central Banks | **10,220** | 5,269 |
| Due from banks and financial institutions | **5,335** | 19,932 |
| Due to banks and financial institutions | **(10,060)** | - |
| | **5,495** | 25,201 |

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



# Statement of Sources and uses of Charity Fund
For the year ended 31 December 2018

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Balance as at 1 January | - | - |
| Non-islamic income for the year | **2,225** | 1,923 |
| **Total source** | **2,225** | 1,923 |
| Use of charity fund: | | |
| Oman Association for disabled | **(742)** | (641) |
| Oman Society for the hearing impaired | **(742)** | (641) |
| Omani Association for Elderly Friends | **(742)** | (641) |
| **Undistributed charity fund** | **-** | - |

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

Notes to the Financial Statements
As at 31 December 2018

## 1 Legal status and principal activities

Muzn Islamic Banking – Window of National Bank of Oman SAOG ('Muzn') was registered in the Sultanate of Oman as a window of National Bank of Oman SAOG. Muzn's principle place of business is in Muscat, Sultanate of Oman.

Muzn's operations commenced on 17 January 2013 and it currently operates through six branches in the Sultanate under the license issued by the Central Bank of Oman on 15 January 2013.

The principle activities of Muzn are taking demand, saving and deposit accounts, providing Murabaha finance, Ijarah financing, Musharaka financing and other Shari'a compliant forms of financing as well as managing investor's money on the basis of Mudaraba or agency for a fee, providing commercial banking services and other investment activities.

Muzn's activities are regulated by the Central Bank of Oman ('CBO') and supervised by Shari'a Supervisory Board ('SSB') comprising of five members.

Muzn's address is PO Box 751 and PC 112, Muscat, Sultanate of Oman.

Muzn employed 62 employees as at 31 December 2018 (2017: 66).

## 2 Basis of preparation

### 2.1 Statement of compliance

The financial statements of Muzn Islamic Banking have been prepared in accordance with Financial Accounting Standards ('FAS') issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI), the Shari'a rules and principles as determined by the Shari'a Supervisory Board of Muzn and the applicable laws and regulations issued by the CBO. In accordance with the requirements of IBRF, for accounting matters which are not covered by the AAOIFI standards, Muzn uses the relevant International Financial Reporting Standards ('IFRS') issued by the International Accounting Standards Board (IASB). The significant accounting policies are set out in note 3 to the financial statements.

These financial statements relate to the Islamic Window operation only and do not include the financial results of the Bank. The complete set of Bank's financial statements are presented separately. The window is not a separate legal entity, the separate financial statements of National Bank of Oman SAOG has been prepared to comply with the requirements of Articles 1.5.1.2 to 1.5.1.4 of Title 2 'General Obligations and Governance' of IBRF issued by Central Bank of Oman

In accordance with the requirements of Central Bank of Oman's circular BM 1149 dated 13 April 2017 Window has adopted IFRS 9. These are the first set of annual financial statements in which IFRS 9 has been applied. Changes to significant accounting policies are described in note 3.24 and the related transition impact is set out in note 3.25.

Statement of restricted investment accountholders and statement of Qard fund and Zakat are not presented as these are not applicable/relevant to Muzn's operations.

### 2.2 Basis of measurement

The financial statements are prepared on historical cost basis except for the measurement at fair value of certain instrument(s) carried at fair value.

### 2.3 Functional and presentation currency

The financial statements have been presented in Rial Omani (RO) which is the functional currency of Muzn. Except as otherwise indicated, financial information presented has been rounded off to the nearest thousand Rial Omani (RO).

### 2.4 Use of estimates and judgements

The preparation of financial statements in conformity with AAOIFI requires management to make judgments estimates and assumptions that effect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected.

Information about significant areas of uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are described in note 4.

## 3 Significant accounting policies

The accounting policies set below have been consistently applied in dealing with items that are considered material in relation to Muzn's financial statements to the period presented.

### 3.1 Foreign currency translations

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in income statement.

Figures are also presented in United States Dollar (USD) for statement of financial position, income statement, statement of changes in equity, statement of cash flows and statement of sources and uses of charity fund, which have been translated from Rial Omani at an exchange rate of RO 0.385 to each US Dollar.

### 3.2 Financial instruments (Policy applicable up to 31 December 2017)

#### 3.2.1 Recognition

Muzn recognises Islamic financial assets and liabilities on the date at which they originated. Regular way purchases and sales of financial assets are recognised on the trade date at which Muzn commits to purchase and sell the asset. All other financial assets and liabilities (including assets and liabilities at fair value through profit or loss) are initially recognised on the trade date at which Muzn becomes a party to the contractual provisions of the instrument.

A financial asset or financial liability is measured initially at fair value, plus for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition or issue.

#### 3.2.2 Derecognition

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

(i) the right to receive cash flows from the asset has expired;

(ii) Muzn has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

#### 3.2.3 Measurement

Financial assets are measured initially at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss.

Subsequent to initial recognition all financial assets are measured at fair value, except equity instrument that does not have a quoted market price in an active market and whose fair value cannot be reliably measured is stated at cost, including transaction costs, less impairment losses.

All non-trading financial liabilities are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective profit rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective profit rate of the instrument.

### 3.3 Cash and cash equivalents

For the purpose of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including: cash on hand, non-restricted cash deposited with the Central Bank of Oman and, amounts due from other banks.

### 3.4 Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of financial position when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Further, this should also be as per the Shari'a principles and guidelines.

Income and expenses are presented on a net basis only for permitted transaction.

### 3.5 Deferred sales under Murabaha

Deferred sales under Murabaha are stated net of deferred profits and provisions for impairment. Muzn considers the promise made in the deferred sales to the purchase orderer as obligatory.

### 3.6 Ijarah Muntahia Bittamleek assets and Forward Ijarah

Ijarah Muntahia Bittamleek assets are initially recorded at cost. Ijarah Muntahia Bittamleek is a lease whereby the legal title of the leased asset passes to the lessee at the end of the Ijarah (lease term), provided that all Ijarah installments are settled.

Depreciation is calculated using the straight-line method on all Ijarah Muntahia Bittamleek assets, at rates calculated to write off the cost of each asset over its useful life.

Forward Ijarah assets are recognised as assets at cost during the period of construction.

### 3.7 Diminishing Musharaka

Musharaka contract represents a partnership between Muzn and a customer whereby each party contributes to the capital in equal or varying proportions to develop a new asset or share an existing one, and whereby each of the party becomes an owner of the capital on a permanent or declining basis and shall have a share of profits or losses.

These are stated at the fair value of consideration given less any amounts written off and provision for impairment, if any. In Diminishing Musharaka based transactions, Muzn enters into a Musharaka based on Shirkat-ul-milk for financing an agreed share of fixed asset (e.g. house or land) with its customers and enters into periodic profit payment agreement on Ijarah basis for the utilisation of Muzn's Musharaka share by the customer.

Over the tenor, one partner's investment in the partnership declines on account of the other partner's

Notes to the Financial Statements
As at 31 December 2018

increase in the partnership investment through repayment of the former partner's share.

### 3.8 Service Ijarah

Deferred Contracts under Service Ijarah are stated net of deferred profits and provisions for impairment. Muzn considers the payments to be made under Deferred Service Ijarah Contracts as obligatory.

### 3.9 Property and equipment

Items of property and equipment are stated at cost less accumulated depreciation and impairment loss. Depreciation is calculated so as to write off the cost of property and equipment, by equal installments over their estimated economic useful lives from the date the asset is brought into use, as follows:

| Nature of assets | Useful life in years |
|---|---|
| Furniture and fixtures | 10 |
| Equipment | 5-20 |
| Motor vehicles | 4 |
| Leasehold improvements | 3-10 |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposal of property and equipment are determined by reference to their carrying amount and are taken into account in determining operating profit. Repairs and renewals are charged to income statement when the expense is incurred. Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the item of property and equipment. All other expenditure is recognised in income statement as an expense when incurred.

### 3.10 Unrestricted investment accountholders

All unrestricted investment accounts will be carried at cost plus profit attributable to unrestricted investment account holders and related reserves, less amounts settled.

Unrestricted investment account holders' share of income will be calculated based on the income generated from investment accounts after deducting Mudarib share. Operating expenses will be charged to shareholders' funds and not included in the calculation.

The basis applied by Muzn in arriving at the unrestricted investment account holders' share of income will be (total income from jointly financed Islamic finances less shareholders' income). Pre agreed profit share generated from unrestricted investment account holders will be deducted as Mudarib share and the remaining will be distributed to the unrestricted investment account holders.

### 3.11 Investments (applicable from 1 January 2018)

Investments comprise of debt type instruments carried at amortised cost, equity type instruments carried at fair value through equity and equity type instruments carried at fair value through statement of income.

All investments, are initially recognised at cost, being the fair value of the consideration given including acquisition charges associated with the investment, except in the case of investments carried at fair value through statement of income.

Debt type instruments carried at amortised cost (Applicable to 2017)

Investments which have fixed or determinable payments and where the Window has both the intent and ability to hold to maturity are classified as debt type instruments carried at amortised cost. Such investments are carried at amortised cost, less provision for impairment in value. Amortised cost is calculated by taking into account any premium or discount on acquisition. Any gain or loss on such instruments is recognised in the statement of comprehensive income when the instruments are de-recognised or impaired.

Debt instruments at FVTE (IFRS 9: FVOCI) (policy applicable from 1 January 2018)

The Window applies the new category under IFRS 9 of debt instruments measured at FVTE 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 SPPI test

For debt securities measured at FVTE, gains and losses are recognised in equity and upon sale realized through Profit and Loss.

When debt security measured at FVTE is derecognised, the cumulative gain or loss previously recognised in fair value reserve is reclassified from equity to profit or loss.

Equity type instruments carried at fair value through equity (Applicable to 2017)

Subsequent to acquisition, equity type instruments are remeasured at fair value, with unrealised gains and losses recognised in a separate component of equity until the investment is derecognised or the investment is determined to be impaired. On derecognition or impairment, the cumulative gain or loss previously recorded in equity is recognised in the statement of comprehensive income for the year.

Impairment losses on equity type instruments carried at fair value through equity are not reversed through the statement of comprehensive income and increases in their fair value after impairment are recognised directly in owners' equity.

Equity instruments at FVTE (IFRS 9:FVOCI) (Policy applicable from 1 January 2018)

Upon initial recognition, the Window occasionally elects to classify irrevocably some of its equity investments as equity instruments at FVTE when they meet the definition of 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. Dividends are recognised in profit or loss as other operating income when the right of the payment has been established, except when the Window benefits from such proceeds as a recovery of part of the cost of the instrument, in which case, such gains are recorded in equity. Equity instruments at FVOCI are not subject to an impairment assessment.

Equity type instruments carried at fair value through statement of income (Applicable to 2017)

These are subsequently re-measured at fair value. All related realised and unrealised gains or losses are included in the statement of comprehensive income.

### 3.11 Investment risk reserve

Investment risk reserves are amounts appropriated out of the income of unrestricted investment account holders, after allocating the Mudarib share, in order to cater against future losses for unrestricted investment account holders.

### 3.12 Profit equalisation reserve

Muzn appropriates a certain amount in excess of the profit to be distributed to unrestricted investment accounts before taking into consideration the Mudarib share of income. This will be used to maintain a certain level of return on investment for unrestricted investment account holders.

### 3.13 Provisions

Provisions are recognised when Muzn has a present obligation (legal or constructive) arising from a past event and the costs to settle the obligation are both probable and able to be measured reliably.

According to the regulations of the Central Bank of Oman; Banks are required to have portfolio credit loss provisions, at least equivalent to 1% of the total financing and interbank 0.5% categorized as Standard and Special Mention. However, for personal finance a minimum portfolio loss provision of 2% of the Standard and Special Mention is required to address the heightened inherent risk.

### 3.14 Dividends

Dividends are recognised as a liability in the year in which they are declared.

### 3.15 Earnings prohibited by shari'a

Muzn is committed to avoid recognising any income generated from non-Islamic sources. Accordingly, all non-Islamic income is credited to a charity fund where Muzn disburses these funds according to the Shari'a Supervisory Board's supervision and instructions.

### 3.16 Zakah

The responsibility of payment of zakah is on individual shareholders and investment account holders.

### 3.17 Joint and self-financed

Financing and receivables that are jointly owned by Muzn and the unrestricted investment accounts holders will be classified under the caption "jointly-financed" in the financial statements. Financing and receivables that are financed solely by Muzn will be classified under "self-financed".

### 3.18 Funds for Muzn

Muzn functions with funds specifically available for its Islamic banking activities and there is no commingling of funds with conventional banking business.

### 3.19 Revenue recognition

#### 3.19.1 Deferred sales under Murabaha

Where the income is quantifiable and contractually determined at the commencement of the contract, income will be recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable or contractually determinable, it will be recognized when realised. Income related to non performing accounts will be excluded from the income statement.

#### 3.19.2 Diminishing Musharaka

Income from Musharaka is recognised when the right to receive payment is established or when distribution is made.

Notes to the Financial Statements
As at 31 December 2018

### 3.19.3 Ijarah Muntahia Bittamleek

Income from Ijarah Muntahia Bittamleek will be recognised on a time-apportioned basis over the lease term, net of depreciation. Income related to non performing Ijarah Muntahia Bittamleek assets will be excluded from the statement of income.

### 3.19.4 Service Ijarah

Where the income is quantifiable and contractually determined at the commencement of the contract, income will be recognised on a time-apportioned basis over the period of the contract based on the principal amounts outstanding. Where the income from a contract is not quantifiable or contractually determinable, it will be recognized when realised. Income related to non performing accounts will be excluded from the income statement.

### 3.19.5 Dividends

Dividends will be recognised when the right to receive payment is established.

### 3.19.6 Fee and Commission Income

Fee and commission income will be recognised when earned.

### 3.19.7 Muzn's Share as a Mudarib

Muzn's share as a Mudarib for managing unrestricted investment accounts will be accrued based on the terms and conditions of the related Mudaraba agreements.

### 3.19.8 Income allocation

Income from jointly financed activities will be allocated proportionately between unrestricted investment accounts and shareholders on the basis of the average balances outstanding during the year.

### 3.20 Taxation

Muzn is not a separate legal entity and therefore is not taxable on a stand-alone basis as per the prevailing tax laws.

National Bank of Oman SAOG is taxable on a consolidated basis i.e including Muzn's financial results, accounted for as per the International Financial Reporting Standards. Accordingly, no current tax and deferred tax has been accounted for in these financial statements.

### 3.21 Employee benefits

End of service benefits are accrued in accordance with the terms of employment of the Muzn's employees at the statement of financial position date, having regard to the requirements of the Oman Labour Law. Employee entitlements to annual leave and leave passage are recognized when they accrue to employees and an accrual is made for the estimated liability arising as a result of services rendered by employees up to the statement of financial position date.

Contributions to a defined contribution retirement plan and occupational hazard insurance for Omani employees in accordance with the Omani Social Insurances Law of 1991 and its subsequent amendments are recognized as an expense in income statement as incurred.

### 3.22 Segment reporting

An operating segment is a component of Muzn that engages in business activities from which it may earn revenues and incur expenses including revenue and expenses that relate to transactions with any of the Muzn's other components whose operating results are reviewed regularly by the management to make decisions about the resources allocated to each segment and asses its performance and for which discrete financial information is available. Muzn's primary format for reporting segmental information is business segment, based upon management internal reporting structure. Muzn's main business segments comprise of retail, corporate and treasury operations.

### 3.23 Shari'a supervisory board

All business activities, products, transactions, agreements, contracts and other relevant documents are subject to the supervision of the Shari'a Supervisory Board of Muzn, which meets four times a year and consists of three prominent Shari'a scholars as voting members and two non-voting members who are expert in the field. The SSB members appointed for a period of three years are:

- Sh. Dr. Mohamed Bin Ali Elgari – Chairman
- Dr. Mohammed Daud Bakar– Member
- H.H. Dr. Adham Al Said – Member
- Sh. Dr. Khalid Al Amri – Member (contract expired in July 2018)
- Sh. Saleh Al Kharusi – Member

### 3.24 IFRS 9 - Financial Instruments

In accordance with the requirements of Central Bank of Oman's circular BM 1149 dated 13 April 2017, the Window has adopted IFRS 9 as issued by the IASB in July 2014 with a date of transition of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the financial statements as of and for the year ended 31 December 2017.

As permitted by the transitional provisions of IFRS 9, the Window elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and the opening balance of fair value reserve of the current period.

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

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

- Comparative periods have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognised in retained earnings and reserves as at 1 January 2018. Accordingly, the information presented for 2017 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented for 2018 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
    a) The determination of the business model within which a financial asset is held.
    b) The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
    c) The designation of certain investments in equity instruments not held for trading as at FVTE (IFRS 9: FVOCI).

If a debt security had low credit risk at the date of initial application of IFRS 9, then the Window has assumed that credit risk on the asset had not increased significantly since its initial recognition.

The key changes to the Window's accounting policies resulting from its adoption of IFRS 9 are summarised below:

### 3.24.1 Classification of financial assets

From 1 January 2018, the Window has applied IFRS 9 and classifies its financial assets in the following measurement categories:

a) Fair value through equity (FVTE) which is IFRS 9: FVOCI; or
b) Amortised cost.
c) Fair value through profit or loss (FVTPL);

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

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

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

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

On initial recognition of an equity investment that is not held for trading, the Window may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis. All other financial assets are classified as measured at FVTPL.

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

### 3.24.2 Business model assessment

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

a) The stated policies and objectives for the portfolio and the operation of those policies in practice. In particular, whether management's strategy focuses on earning contractual profits, maintaining a particular profit rate profile, matching the duration of the financial assets to the duration of the liabilities that are funding those assets or realising cash flows through the sale of the assets;
b) how the performance of the portfolio is evaluated and reported to the Window's management;
c) the risks that affect the performance of the business model (and the financial assets held within that business model) and how those risks are managed;
d) how managers of the business are compensated – e.g. whether compensation is based on the fair value of the assets managed or the contractual cash flows collected; and
e) The frequency, volume and timing of sales in prior periods, the reasons for such sales and its expectations about future sales activity. However, information

Notes to the Financial Statements
As at 31 December 2018

about sales activity is not considered in isolation, but as part of an overall assessment of how the Window's stated objective for managing the financial assets is achieved and how cash flows are realised.

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 Window's original expectations, the Window 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.

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

### 3.24.3 Assessment whether contractual cash flows are solely payments of principal and profits ('SPPP')

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

a) contingent events that would change the amount and timing of cash flows;
b) leverage features;
c) prepayment and extension terms;
d) terms that limit the Window's claim to cash flows from specified assets (e.g. non-recourse asset arrangements); and
e) features that modify the profit rates based on the given circumstances.

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 FVPL.

The 'investments' caption in the statement of financial position includes:

a) debt investment securities measured at amortised cost; these are initially measured at fair value plus incremental direct transaction costs, and subsequently at their amortised cost using the effective profit method;
b) debt and equity investment securities mandatorily measured at FVTPL or designated as at FVTPL; these are at fair value with changes recognised immediately in profit or loss;
c) debt securities measured at FVTE; and
d) equity investment securities designated as at FVTE.

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

a) Profits from the financial assets
b) ECL and reversals; and
c) Foreign exchange gains and losses.

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

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

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

### 3.24.4 Reclassifications

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

### 3.24.5 Impairment

Policies applicable from 01 January 2018

The Window recognises loss allowances for ECL on the following financial instruments that are not measured at FVTPL:

a) financial assets that are debt instruments;
b) financial guarantee contracts issued; and
c) financing commitments issued.

No impairment loss is recognised on equity investments. The Window measures loss allowances at an amount equal to lifetime ECL, except for the following, for which they are measured as 12-month ECL:

a) debt investment securities that are determined to have low credit risk at the reporting date; and
b) other financial instruments (other than lease receivables) on which credit risk has not increased significantly since their initial recognition.

Credit-impaired financial assets

At each reporting date, the Window assesses whether financial assets carried at amortised cost and debt financial assets carried at FVTE are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred. Evidence that a financial asset is credit-impaired includes the following observable data:

a) significant financial difficulty of the borrower or issuer;
b) a breach of contract such as a default or past due event;
c) the restructuring of a financing or advance by the Window on the terms that the Window would not consider otherwise;
d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
e) the disappearance of an active market for a security because of financial difficulties.

A financing that has been renegotiated due to a deterioration in the borrower's condition is usually considered to be credit-impaired unless there is evidence that the risk of not receiving contractual cash flows has reduced significantly and there are no other indicators of impairment. In addition, a retail financing exposure that is overdue for 90 days or more is considered impaired.

In making an assessment of whether an investment in sovereign debt is credit-impaired, the Window considers the following factors.

a) The market's assessment of creditworthiness as reflected in the Sukuk yields.
b) The rating agencies' assessments of creditworthiness.
c) The country's ability to access the capital markets for new debt issuance.
d) The probability of debt being restructured, resulting in holders suffering losses through voluntary or mandatory debt forgiveness.
e) The international support mechanisms in place to provide the necessary support as 'lender of last resort' to that country, as well as the intention, reflected in public statements, of governments and agencies to use those mechanisms. This includes an assessment of the depth of those mechanisms and, irrespective of the political intent, whether there is the capacity to fulfil the required criteria.

Calculation of expected credit loss (ECL)

Changes to the assumptions and estimate on uncertainties that have a significant impact on ECL for the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments. The impact is mainly driven by inputs, assumptions and techniques used for ECL calculation under IFRS 9 methodology.

Inputs, assumptions and techniques used for ECL calculation – IFRS 9 Methodology

Key concepts in IFRS 9 that have the most significant impact and require a high level of judgment, as considered by the Window while determining the impact assessment, are:

Assessment of Significant Increase in Credit Risk

The assessment of a significant increase in credit risk is done on a relative basis. To assess whether the credit risk on a financial asset has increased significantly since origination, the Window compares the risk of default occurring over the expected life of the financial asset at the reporting date to the corresponding risk of default at origination, using key risk indicators that are used in the Window's existing risk management processes.

The Window's assessment of significant increases in credit risk is being performed at least quarterly for each individual exposure based on eleven factors. If any of the following factors indicates that a significant increase in credit risk has occurred, the instrument will be moved from Stage 1 to Stage 2:

The Window will consider a financial asset to have experienced a significant increase in credit risk when one or more of the following quantitative, qualitative or backstop criteria have been met:

a. The remaining Lifetime PD at the reporting date has increased as result of downgrading of internal rating by two notches;
b. Inadequate or unreliable financial and other information such as unavailability of audited financial statement
c. Non-cooperation by the counterparty in matter pertaining to documentation
d. Counterparty is the subject of litigation by third parties that may have a significant impact on his financial position
e. Frequent changes in senior management
f. Intra-group transfer of funds without underlying transactions
g. Deferment/delay in the date for commencement of commercial operations by more than one year
h. Modification of terms resulting in concessions granted to counterparty including extension of

Notes to the Financial Statements
As at 31 December 2018

moratorium, deferment of payment, waiver of covenants, etc. In applying this requirement, bank is guided by the extant instructions of CBO in regard to treating an account as restructured.

i. A fall of 25 percent or more in the turnover or in the EBIT as compared to previous year.
j. Erosion in net-worth by more than 20 percent as compared to the previous year and coupled with an increase in leverage.
k. A fall in the debt service ratio.

IFRS 9 contains a rebuttable presumption that instruments which are 30 days past due have experienced a significant increase in credit risk.

Movements between Stage 2 and Stage 3 are based on whether financial assets are credit-impaired as at the reporting date. The determination of credit-impairment under IFRS 9 will be similar to the individual assessment of financial assets for objective evidence of impairment under IAS 39.

### Macroeconomic Factors, Forward Looking Information (FLI) and Multiple Scenarios

The measurement of ECL for each stage and the assessment of significant increases in credit risk considers information about past events and current conditions as well as reasonable and supportable forecasts of future events and economic conditions. The estimation and application of forward-looking information requires significant judgment.

Probability of Default (PD), Loss Given Default (LGD) and Exposure At Default (EAD) inputs used to estimate Stage 1 and Stage 2 credit loss allowances are modelled based on the macroeconomic variables (or changes in macroeconomic variables), that are closely correlated with credit losses in the relevant portfolio.

The windows base case scenario is based on macroeconomic forecasts using historical information from external sources including impact of portfolio and industry related information. Where worse-case scenario is developed taking the historical information of defaults and is regressed to arrive at forward looking results.

Scenarios are probability-weighted according to the window best estimate of their relative likelihood based on historical frequency and current trends and conditions. Probability weights are updated on an annual basis (if required).

### Definition of default

The definition of default used in the measurement of ECL and the assessment to determine movement between stages is consistent with the definition of default used for internal credit risk management purposes. IFRS 9 does not define default, but contains a rebuttable presumption that default has occurred when an exposure is greater than 90 days past due.

### Expected life

When measuring ECL, the Window must consider the maximum contractual period over which the Window is exposed to credit risk. All applicable contractual terms are considered when determining the expected life, including prepayment options and extension and rollover options. For certain revolving credit facilities that do not have a fixed maturity, the expected life is estimated based on the period over which the Window is exposed to credit risk and where the credit losses would not be mitigated by management actions.

### Overview of the ECL principles

The adoption of IFRS 9 has fundamentally changed the Window's financing loss impairment method by replacing incurred loss approach with a forward-looking ECL approach. From 1 January 2018, the Window has been recording the allowance for expected credit losses for all financing exposure and other debt financial assets not held at FVPL, together with financing commitments and financial guarantee contracts. Equity instruments are not subject to impairment under IFRS 9.

The ECL allowance is based on the credit losses expected to arise over the life of the asset (the lifetime expected credit loss (LTECL), unless there has been no significant increase in credit risk since origination, in which case, the allowance is based on the 12 months' expected credit loss (12-month ECL).

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

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

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

Based on the above process, the Window groups its financing exposure into Stage 1, Stage 2, and Stage 3, as described below:

#### Stage 1

When financing are first recognised, the Window recognises an allowance based on 12 month ECLs. Stage 1 financing exposure also include facilities where the credit risk has improved and the financing exposure has been reclassified from Stage 2.

#### Stage 2

When a financing exposure has shown a significant increase in credit risk since origination, the Window records an allowance for the LTECLs. Stage 2 financing exposure also include facilities, where the credit risk has improved and the financing exposure has been reclassified from Stage 3.

#### Stage 3

Financing exposure considered credit-impaired. The Window records an allowance for the LTECLs.

At initial recognition of a financial asset, the Window recognises a loss allowance equal to 12-month expected credit losses. After initial recognition, the three stages under the proposals would be applied as follows:

#### Stage 1

Credit risk has not increased significantly since initial recognition – recognise 12-month expected credit losses.

#### Stage 2

Credit risk has increased significantly since initial recognition – recognise lifetime expected losses (this is recognising a provision earlier than under IAS 39 Financial assets: Recognition and Measurement) with revenue being calculated based on the gross amount of the asset.

#### Stage 3

There is objective evidence of impairment as at the reporting date to recognise lifetime expected losses, with revenue being based on the net amount of the asset (that is, based on the impaired amount of the asset).

Purchased or originated credit impaired (POCI) assets are financial assets that are credit impaired on initial recognition. POCI assets are recorded at fair value at original recognition and profit is subsequently recognised based on a credit-adjusted effective profit rate (EPR). ECLs are only recognised or released to the extent that there is a subsequent change in the expected credit losses.

For financial assets for which the Window has no reasonable expectations of recovering either the entire outstanding amount, or a proportion thereof, the gross carrying amount of the financial asset is reduced. This is considered a (partial) derecognition of the financial asset.

### The calculation of ECLs

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

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

- PD – The Probability of Default is an estimate of the likelihood of default over a given time horizon. A default may only happen at a certain time over the assessed period, if the facility has not been previously derecognised and is still in the portfolio.
- EAD – The Exposure at Default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and profit, whether scheduled by contract or otherwise, expected drawdowns on committed facilities, and accrued profit from missed payments.

LGD - The Loss Given Default is an estimate of the loss arising in the case where a default occurs at a given time. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including from the realisation of any collateral, if any. It is usually expressed as a percentage of the EAD. The Window has applied a LGD of 0% on Government Sukuk issued by Government of Oman which are classified as investments under amortised cost.

Notes to the Financial Statements
As at 31 December 2018

### 3.25 Impact of adopting IFRS 9

The impact of adopting IFRS 9 as at 1 January 2018 has been decreasing accumulated losses by RO 296,000.

| | Accumulated losses RO'000 |
|---|---|
| **Closing balance (31 December 2017)** | (2,409) |
| Impact on recognition of Expected Credit Losses | |
| Expected credit losses under IFRS 9 for financing contracts at amortised cost including undrawn portion of financing contracts and financial guarantees | (365) |
| Expected credit losses under IFRS 9 for due from banks* | - |
| Expected credit losses under IFRS 9 for undrawn portion of financing contracts and financial guarantees* | - |
| Expected credit losses under IFRS 9 for investment securities at amortised cost | 69 |
| **Estimated adjusted opening balance on date of initial application of 1 January 2018** | **(2,113)** |

Expected credit loss / Impairment allowances

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

| | 31 December 2017 RO'000 | Re-measurement RO'000 | 01 January 2018 RO'000 |
|---|---|---|---|
| Financing contracts with customers | 1,332 | (365) | 967 |
| Available-for-sale debt investment securities under IAS 39/debt financial assets at FVOCI under IFRS 9 | - | 69 | 69 |
| | **1,332** | **(296)** | **1,036** |

**Based on the IFRS9 ECL model, the expected credit losses under IFRS 9 for due from banks and undrawn portion of financing contracts and financial guarantees is not material and accordingly no impact on adopting IFRS 9 as at 1 January 2018 has been recorded by the Window.*

Classification and Measurement of Financial Instruments

The Window performed a detailed analysis of its business models for managing financial assets as well as analysing their cash flow characteristics. The below table reconciles the original measurement categories and carrying amounts of financial assets in accordance with IAS 39 and the new measurement categories under IFRS 9 as at 31 December 2017.

| | | | | Impact of IFRS 9 | | |
|---|---|---|---|---|---|---|
| | Original classification under IAS 39 | New classification under IFRS 9 | Original carrying amount RO'000 | Re-measurement RO'000 | Re-classification RO'000 | New carrying amount RO'000 |
| **Financial assets** | | | | | | |
| Cash and balances with central bank | Financing and receivables | Amortised cost | 5,269 | - | - | 5,269 |
| Due from banks | Financing and receivables | Amortised cost | 19,932 | - | - | 19,932 |
| Financing contracts with customers | Financing and receivables | Amortised cost | 102,781 | 365 | - | 103,146 |
| Financial Assests Held for Trading | Held-for-trading | Amortised cost | 3,550 | (69) | - | 3,481 |
| Financial Assests Held to Maturity | Held-to-maturity | Amortised cost | 1,926 | - | - | 1,926 |
| Others assests | Loans and receivables | Amortised cost | 247 | - | - | 247 |

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

### 3.26 New standards, amendments and interpretations

#### 3.26.1 New standards, amendments and interpretations effective from 1 January 2018

For the year ended 31 December 2018, the Window has adopted all of the amendments in standards issued by AAOIFI that are relevant to tis operations and effective for the period beginning on 1 January 2018.

FAS 28 Murabaha and Other Deferred Payment Sales

AAOIFI has issued FAS 28 Murabaha and Other Deferred Payment Sales in 2017. FAS 28 supersedes the earlier FAS No. 2 “Murabaha and Murabaha to the Purchase Orderer” and FAS No. 20 “Deferred Payment Sale”. The objective of this standard is to prescribe the appropriate accounting and reporting principles for recognition, measurement and disclosures in relation to Murabaha and other deferred payment sales transactions for the sellers and buyers, for such transactions. This standard shall be effective for the financial periods beginning on or after 1 January 2019 with early adoption permitted.

The Window is currently evaluating the impact of this standard.

FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar)

AAOIFI has issued FAS 31 Investment Agency (Al-Wakala Bi Al-Istithmar) in 2018. The objective of this standard is to establish the principles of accounting and financial reporting for the investment agency (Al-Wakala Bi Al- Istithmar) instruments and the related assets and obligations from both the principal (investor) and the agent perspectives. This standard shall be effective for the financial periods beginning on or after 1 January 2020 with early adoption permitted.

The Window is currently evaluating the impact of this standard.

FAS 35 Risk Reserves

AAOIFI has issued FAS 35 “Risk Reserves” in 2018. This standard along with FAS 30 ‘Impairment, Credit losses and onerous commitments’ supersede the earlier FAS 11 “Provisions and reserves”.

The objective of this standard is to establish the principles of accounting and financial reporting for risk reserves established to mitigate various risks faced by stakeholders, mainly the profit and loss taking investors, of Islamic financial institutions (IFIs/ the institutions). This standard shall be effective for the financial periods beginning on or after 1 January 2021 with early adoption permitted only if the Group early adopts FAS 30 “Impairment, Credit losses and onerous commitments”.

The Window is currently evaluating the impact of this standard.

Notes to the Financial Statements
As at 31 December 2018

FAS 30 Impairment, Credit losses and onerous commitments

In November 2017, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) issued Financial Accounting Standard (FAS) 30 - Impairment, credit losses and onerous commitments, the standard supersedes the earlier FAS 11 "Provisions and Reserves" effective from the financial periods beginning on or after 1 January 2020, with early adoption permitted.

However, during the year 2017, the CBO has issued a circular BM 1149 dated 13 April 2017 governing implementation of IFRS 9 Financial Instruments (IFRS 9) for all the banks, which also apply to Islamic banks/windows subject to any specific instructions by the Central Bank for Islamic Banking entities on IFRS 9 if, as and when instructions are issued.

The Window adopted IFRS 9 on 1 January 2018 and did not restate the comparative information in accordance with relevant requirements of IFRS 9. IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement and introduces new requirements for the classification and measurement of financial assets and financial liabilities, a new model based on expected credit losses for recognising loan loss provisions more closely with risk management methodology.

The key changes to the Window's accounting policies resulting from its adoption of IFRS 9 are summarised below.

(i) Classification and measurement

IFRS 9 contains classification and measurement approach for financial assets that reflects the business model in which financial assets are managed and the underlying cash flow characteristics. IFRS 9 contains three principal classification categories for financial assets: (a) measured at Amortised Cost (AC), Fair Value through Other Comprehensive Income (FVOCI) and Fair Value through Profit or Loss (FVPL). Under IFRS 9, derivatives embedded in contracts where the host is a financial asset are never bifurcated. Instead, the hybrid financial instrument as a whole is assessed for classification.

(ii) Expected credit losses

IFRS 9 replaces the 'incurred loss' model in IAS 39 with a forward-looking 'expected credit loss' (ECL) model. The new impairment model will apply to financial assets measured at amortised cost or FVOCI, except for investments in equity instruments. A number of significant judgements are also required in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for significant increase in credit risk (SICR);
- Choosing appropriate models and assumptions for the measurement of ECL;
- Establishing the number and relative weightings of forward-looking scenarios for each type of product/market and the associated ECL; and
- Establishing groups of similar financial assets for the purposes of measuring ECL.

The Central Bank of Oman (CBO) has issued guidelines relating to implementation of IFRS 9. The relevant requirements relating to transition are set out below:

- Should the existing financing loss impairment computed in accordance with the requirements of IAS 39 and CBO guidelines be higher than the impairment allowance computed under IFRS 9, the related difference (net of tax) be transferred to a financing loss impairment reserve from retained earnings as of 1 January 2018.
- In the subsequent years, where the allowance for financing loss impairment computed in accordance with CBO requirements is higher than the allowance for financing loss impairment loss computed under IFRS 9, the difference (net of tax) should be transferred to the aforementioned financing loss impairment reserve from retained earnings.
- The related impairment reserve will not be available for dividend distribution or for inclusion in the regulatory capital. Any subsequent utilisation of the impairment reserve would require prior approval of the CBO.

(iii) Financial liabilities

Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The key change is that an entity will be required to present the effects of changes in own credit risk of financial liabilities designated at fair value through profit or loss in other comprehensive income.

As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, the Bank does not expect a significant impact as a result of applying IFRS 9.

(iv) Disclosure

IFRS 9 also introduces expanded disclosure requirements and changes in presentation. These are expected to change the nature and extent of the Bank's disclosures about its financial instruments particularly in the year of the adoption of IFRS 9.

## 4 Critical accounting judgment and key sources of estimation uncertainty

### 4.1 Financial Instruments (applicable from 1 January 2018)

Judgements made in applying accounting policies that have most significant effects on the amounts recognized in the financial statements of the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments which impact:

- Classification of financial assets: assessment of business model within which the assets are held and assessment of whether the contractual terms of the financial assets are solely payment of principal and profit of the principal amount outstanding.
- Calculation of expected credit loss (ECL): changes to the assumptions and estimate on uncertainties that have a significant impact on ECL for the year ended 31 December 2018 pertain to the changes introduced as a result of adoption of IFRS 9: Financial instruments. The impact is mainly driven by inputs, assumptions and techniques used for ECL calculation under IFRS 9 methodology.

Inputs, assumptions and techniques used for ECL calculation – IFRS 9 Methodology

Key concepts in IFRS 9 that have the most significant impact and require a high level of judgment, as considered by the Bank while determining the impact assessment, are:

- Assessment of significant Increase in credit risk
- Macro-economic factors, forward looking information and multiple scenarios
- Definition of default
- Expected life

Detail on criteria for significant increase in credit risk, macro-economic factors, forward looking information and multiple factors and definition of default and expected life is given on the note reference 2.6.5 of the financial statement.

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

- The Window's internal credit grading model
- The Window's criteria for assessing if there has been a significant increase in credit risk and so allowances for financial assets should be measured on a Lifetime Expected Credit Losses (LTECL) basis and the qualitative assessment
- The segmentation of financial assets when their ECL is assessed on a collective basis
- Development of ECL models, including the various formulas and the choice of inputs
- Determination of associations between macroeconomic scenarios and, economic inputs, such as unemployment levels and collateral values, and the effect on Probability of Default (PD), Exposure At Default (EAD) and Loss Given Default (LGD)
- Selection of forward-looking macroeconomic scenarios and their probability weightings, to derive the economic inputs into the ECL models.

### 4.2 Impairment losses on financing (Policy applicable up to 31 December 2017)

Management reviews its financing portfolio to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the statement of income, management makes judgment's as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of finances before the decrease can be identified with an individual receivable in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of customers in a group that correlates with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

### 4.3 Useful life of property and equipment

Depreciation is charged so as to write off the cost of assets over their estimated useful lives. The calculation of useful lives is based on management's assessment of various factors such as the operating cycles, the maintenance programs, and normal wear and tear using its best estimates.

Notes to the Financial Statements
As at 31 December 2018

## 5 Cash and balances with Central Bank of Oman ("CBO")

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Cash in hand | 1,172 | 1,085 |
| Balances with Central Bank of Oman ("CBO") | **9,048** | 4,184 |
| **Cash and balances with Central bank of Oman ("CBO")** | **10,220** | 5,269 |

All the above exposures are classified as Stage 1 as at 31 December 2018.

ECL on the cash and balances with Central Banks is not material and accordingly no adjustment has been accounted by the Bank.

## 6 Due from banks and financial institutions

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2018 RO'000 |
|---|---|---|---|
| Due from foreign banks (note a) | 134 | 201 | 335 |
| Due from local banks (note b) | 2,000 | 3,000 | 5,000 |
| Due from banks and financial institutions | 2,134 | 3,201 | 5,335 |
| Less: Allowance for credit losses | - | - | - |
| **Due from banks and financial institutions after Adopting IFRS9** | **2,134** | **3,201** | **5,335** |

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2017 RO'000 |
|---|---|---|---|
| Due from foreign banks | 1,905 | 2,858 | 4,763 |
| Due from local banks | 6,068 | 9,101 | 15,169 |
| **Due from banks and financial institutions** | **7,973** | **11,959** | **19,932** |

(a) Due from foreign banks is from a international bank with AA rating with a current maturity, due to which the computed ECL is insignificant amount.

(b) Due from local banks is from a local bank with BB rating with current maturity, due to which the computed ECL is insignificant amount.

## 7 Financial assets

### 7.1 Financial assets at amortised cost

| | Self-financed RO'000 | Total 2018 RO'000 |
|---|---|---|
| Government Sukuk | 6,790 | 6,790 |
| Manufacturing Sector Sukuk | 963 | 963 |
| Banking Sector Sukuk | 550 | 550 |
| Financial assets at amortised cost | 8,303 | 8,303 |
| Less: Allowance for credit losses (refer 7.2) | (55) | (55) |
| **Financial assets at amortised cost after Adopting IFRS9** | **8,248** | 8,248 |

## 7 Financial assets (continued)

### 7.1 Financial assets at amortised cost (continued)

| | Self-financed RO'000 | Total 2017 RO'000 |
|---|---|---|
| Government Sukuk | 3,963 | 3,963 |
| Manufacturing Sector Sukuk | 963 | 963 |
| Banking Sector financial asset at FVOCI and FVTPL amortised cost | 550 | 550 |
| **Financial assets at amortised cost** | **5,476** | 5,476 |

### 7.2 Movement in allowances for the credit losses is set out below:

| | 2018 RO | 2017 RO |
|---|---|---|
| Balance at beginning of year | **N/A** | N/A |
| Impact of adopting IFRS 9 (refer note 3.25) | **69** | N/A |
| Impairment losses as at 1 January 2018 | **69** | N/A |
| Released/provided during the year | **(14)** | N/A |
| **Total** | **55** | N/A |

## 8 Deferred sales under Murabaha

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2018 RO'000 |
|---|---|---|---|
| Gross deferred sales under Murabaha | 689 | 1,033 | **1,722** |
| Less: Unearned income | (58) | (87) | **(145)** |
| | 631 | 946 | **1,577** |
| Less: Allowances for credit losses | (3) | (5) | **(8)** |
| **Deferred sales under Murabaha** | **628** | **941** | **1,569** |

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2017 RO'000 |
|---|---|---|---|
| Gross deferred sales under Murabaha | 729 | 1,094 | 1,823 |
| Less: deferred profit under Murabaha | (51) | (76) | (127) |
| | 678 | 1,018 | 1,696 |
| Less: Allowances for credit losses | (12) | (19) | (31) |
| **Deferred sales under Murabaha** | **666** | **999** | **1,665** |

The deferred sales under Murabaha pertain to finance provided to retail customers. The credit quality of the deferred sales under Murabaha that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by Muzn.

Notes to the Financial Statements
As at 31 December 2018

Deferred sales under Murabaha past due but not impaired

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Past due up to 30 days | **80** | 171 |
| Past due 30 – 60 days | - | 15 |
| Past due 60 – 89 days | - | - |
| **Total** | **80** | 186 |

## 9 Ijarah Muntahia Bittamleek – net

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total RO'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2018 | 45,322 | 67,982 | 113,304 |
| Additions - net | 3,105 | 4,657 | 7,762 |
| At 31 December 2018 | 48,427 | 72,639 | 121,066 |
| **Depreciation** | | | |
| At 1 January 2018 | (10,683) | (16,025) | (26,708) |
| Charge for the year | (3,627) | (5,440) | (9,067) |
| At 31 December 2018 | (14,310) | (21,465) | (35,775) |
| Net book value at 31 December 2018 | 34,117 | 51,174 | 85,291 |
| Less: Allowances for credit losses | (451) | (677) | (1,128) |
| **Ijarah Muntahiah Bittamleek – net** | **33,666** | **50,497** | **84,163** |

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total RO'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2017 | 41,360 | 62,040 | 103,400 |
| Additions – net | 3,962 | 5,942 | 9,904 |
| At 31 December 2017 | 45,322 | 67,982 | 113,304 |
| **Depreciation** | | | |
| At 1 January 2017 | (7,297) | (10,948) | (18,245) |
| Charge for the year | (3,386) | (5,077) | (8,463) |
| At 31 December 2017 | (10,683) | (16,025) | (26,708) |
| Net book value at 31 December 2017 | 34,639 | 51,957 | 86,596 |
| Less: provision for doubtful debts | (458) | (686) | (1,144) |
| **Ijarah Muntahiah Bittamleek – net** | **34,181** | **51,271** | **85,452** |

The Ijarah Muntahia Bittamleek pertains to finance provided to retail and corporate customers. The credit quality of the Ijarah Muntahia Bittamleek that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by Muzn.

Ijarah Muntahia Bittamleek past due but not impaired

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Past due up to 30 days | 7,250 | 12,121 |
| Past due 30 – 60 days | 1,999 | 1,861 |
| Past due 60 – 89 days | 669 | 154 |
| **Total** | **9,918** | 14,136 |

## 10 Diminishing Musharaka

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2018 RO'000 |
|---|---|---|---|
| Diminishing Musharaka receivables | 10,494 | 15,741 | 26,235 |
| Less: Allowances for credit losses | (44) | (66) | (110) |
| **Total** | **10,450** | **15,675** | **26,125** |

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2017 RO'000 |
|---|---|---|---|
| Diminishing Musharaka receivables | 4,448 | 6,672 | 11,120 |
| Less: Provision for doubtful receivables | (44) | (68) | (112) |
| **Total** | **4,404** | **6,604** | **11,008** |

Diminishing Musharaka pertains to finance provided to retail and corporate customers. The credit quality of the Diminishing Musharaka that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by Muzn.

Diminishing Musharaka past due but not impaired

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Past due up to 30 days | 10,233 | 878 |
| Past due 30 – 60 days | 224 | 233 |
| Past due 60 – 89 days | 657 | – |
| **Total** | **11,114** | 1,111 |

Notes to the Financial Statements
As at 31 December 2018

## 11 Forward Ijarah

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2018 RO'000 |
|---|---|---|---|
| Forward Ijarah receivables | 1,888 | 2,833 | 4,721 |
| Less: Allowances for credit losses | (10) | (14) | (24) |
| Total | 1,878 | 2,819 | 4,697 |

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2017 RO'000 |
|---|---|---|---|
| Forward Ijarah receivables | 1,881 | 2,822 | 4,703 |
| Less: Provision for doubtful receivables | (19) | (28) | (47) |
| Total | 1,862 | 2,794 | 4,656 |

Forward Ijarah pertains to finance provided to retail and corporate customers. The credit quality of the Forward Ijarah that were neither past due nor impaired can be assessed by reference to the internal rating system adopted by Muzn.

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Past due up to 30 days | 268 | 584 |
| Past due 30 – 60 days | - | 44 |
| Past due 60 – 89 days | 400 | - |
| Total | 668 | 628 |

## 12 Service Ijarah

| | Self- Financed RO'000 | Jointly Financed RO'000 | Total 2018 RO'000 |
|---|---|---|---|
| Gross deferred Service Ijarah | 6 | 8 | 14 |
| Less: Unearned income | (1) | (2) | (3) |
| | 5 | 6 | 11 |
| Less: Allowances for credit losses | - | - | - |
| Service Ijarah | 5 | 6 | 11 |

## 13 Property and equipment – net

| | Motor vehicles, furniture and equipment RO'000 | Leasehold improvements RO'000 | Total RO'000 |
|---|---|---|---|
| **Cost** | | | |
| 1 January 2018 | 1,326 | 701 | 2,027 |
| Additions | 13 | - | 13 |
| 31 December 2018 | 1,339 | 701 | 2,040 |
| **Depreciation** | | | |
| 1 January 2018 | 775 | 653 | 1,428 |
| Charge for the year | 160 | 31 | 191 |
| 31 December 2018 | 935 | 684 | 1619 |
| Net book value at 31 December 2018 | 404 | 17 | 421 |

| | Motor vehicles, furniture and equipment RO'000 | Leasehold improvements RO'000 | Total RO'000 |
|---|---|---|---|
| **Cost** | | | |
| 1 January 2017 | 927 | 614 | 1,541 |
| Additions | 399 | 87 | 486 |
| 31 December 2017 | 1,326 | 701 | 2,027 |
| **Depreciation** | | | |
| 1 January 2017 | 578 | 575 | 1,153 |
| Charge for the year | 197 | 78 | 275 |
| 31 December 2017 | 775 | 653 | 1,428 |
| Net book value at 31 December 2018 | 551 | 48 | 599 |

## 14 Other assets

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Profit receivable | 130 | 123 |
| Advanced rent | 87 | 93 |
| Miscellaneous assets | 125 | 31 |
| | 342 | 247 |

## 15 Wakala Accounts

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Wakala deposit | 52,479 | 47,826 |
| Flex Wakala | 51,037 | 61,683 |
| | 103,516 | 109,509 |

Notes to the Financial Statements
As at 31 December 2018

## 16 Due to banks and financial institutions

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Due to Head Office | 10,060 | - |
| **Due to banks and financial institutions** | **10,060** | - |

## 17 Other liabilities

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Sundry creditors | 227 | 111 |
| Short term payable | 18 | 8 |
| Profits payable | 2,079 | 2,045 |
| Forward Ijarah advances | 2,174 | 1,190 |
| Deferred profit under Murabaha | 143 | 127 |
| | **4,641** | **3,481** |

## 18 Provisions for credit loss finances and recoveries and release from provions of credit loss finances

### 18.1 Portfolio provision

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| At 1 January | 1,261 | 1,294 |
| Impact of adopting IFRS9 | (296) | - |
| Restated opening balance under IFRS9 | 965 | 1,294 |
| Provided during the year | 374 | 9 |
| Released during the year | (15) | (42) |
| **At 31 December** | **1,324** | **1,261** |

### 18.2 Comparison of provision held as per IFRS 9 and required as per CBO guidelines

| Asset Classification as per CBO Norms | Asset Classification as per IFRS 9 | Gross amount RO 000 | Provision required as per CBO Norms RO 000 | Provision held as per IFRS 9 RO 000 | Difference between CBO provision required and provision held RO 000 | Net Amount as per CBO norms* RO 000 | Net Amount as per IFRS 9 RO 000 | Profit recognised in P&L as per IFRS 9 RO 000 | Reserve Profit as per CBO norms RO 000 |
|---|---|---|---|---|---|---|---|---|---|
| (1) | (2) | (3) | (4) | (5) | (6) = (4)-(5)-(10) | (7)=(3)-(4)-(10) | (8) = (3)-(5) | (9) | (10) |
| Standard | Stage 1 | 63,333 | 643 | 294 | 349 | 62,690 | 63,039 | - | - |
| | Stage 2 | 43,590 | 449 | 277 | 172 | 43,141 | 43,31 | - | - |
| | Stage 3 | - | - | - | - | - | - | - | - |
| **Subtotal** | | **106,923** | **1,092** | **571** | **521** | **105,831** | **106,352** | - | - |
| Special Mention | Stage 1 | - | - | - | - | - | - | - | - |
| | Stage 2 | 8,660 | 87 | 30 | 57 | 8,573 | 8,630 | - | - |
| | Stage 3 | - | - | - | - | - | - | - | - |
| **Subtotal** | | **8,660** | **87** | **30** | **57** | **8,573** | **8,630** | - | - |
| Substandard | Stage 1 | - | - | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - | - | - |
| | Stage 3 | 1,429 | 348 | 546 | (161) | 1,044 | 883 | - | 37 |
| **Subtotal** | | **1,429** | **348** | **546** | **(161)** | **1,044** | **883** | - | **37** |
| Doubtful | Stage 1 | - | - | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - | - | - |
| | Stage 3 | - | - | - | - | - | - | - | - |
| **Subtotal** | | - | - | - | - | - | - | - | - |
| Loss | Stage 1 | - | - | - | - | - | - | - | - |
| | Stage 2 | - | - | - | - | - | - | - | - |
| | Stage 3 | 822 | 190 | 123 | 167 | 532 | 699 | - | 100 |
| **Subtotal** | | **822** | **190** | **123** | **167** | **532** | **699** | - | **100** |
| Other items not covered under CBO circular BM 977 and related instructions | Stage 1 | 13,637 | - | 55 | (55) | 13,637 | 13,583 | - | - |
| | Stage 2 | - | - | - | - | - | - | - | - |
| | Stage 3 | - | - | - | - | - | - | - | - |
| Subtotal | | 13,637 | - | 55 | (55) | 13,637 | 13,583 | - | - |
| **Total** | **Stage 1** | **76,970** | **643** | **348** | **294** | **76,328** | **76,622** | **-** | **-** |
| | **Stage 2** | **52,250** | **536** | **306** | **229** | **51,714** | **51,944** | **-** | **-** |
| | **Stage 3** | **2,251** | **538** | **669** | **6** | **1,576** | **1,582** | **-** | **137** |
| | **Total** | **131,471** | **1,717** | **1,324** | **529** | **129,618** | **130,147** | **-** | **137** |

Notes to the Financial Statements
As at 31 December 2018

### 18.3 Movement in Expected credit losses (ECL)

| | Stage 1 RO' 000 | Stage 2 RO' 000 | Stage 3 RO' 000 | Total RO' 000 |
|---|---|---|---|---|
| **Exposure subject to ECL** | | | | |
| – Financing contracts with customers | 63,333 | 52,250 | 2,251 | 117,834 |
| – Investment securities at amortised cost | 8,303 | - | - | 8,303 |
| – Unutilized portion of financing contracts and Financial Guarantees | 176 | - | - | 176 |
| – Due from banks, Central Bank and Other Financial Assets | 5,335 | - | - | 5,335 |
| | | | | |
| **Opening Balance (Day 1 impact) - as at 1 January 2018** | | | | |
| – Financing contracts with customers | 342 | 357 | 268 | 967 |
| – Investment securities at amortised cost | 69 | - | - | 69 |
| – Financing Commitments and Financial Guarantees | - | - | - | - |
| – Due from banks, Central Bank and Other Financial Assets | - | - | - | - |
| | **411** | **357** | **268** | **1,036** |
| **Net transfer between stages** | | | | |
| – Financing contracts with customers | (76) | 49 | 27 | - |
| – Investment securities at amortised cost | - | - | - | - |
| – Unutilized portion of financing contracts and Financial Guarantees | - | - | - | - |
| – Due from banks, Central Bank and Other Financial Assets | - | - | - | - |
| **Charge for the Period (net)** | | | | |
| – Financing contracts with customers (including contractual interest reserved of RO 66 thousand) | 28 | (100) | 374 | 302 |
| – Investment securities at amortised cost | (15) | - | - | (15) |
| – Unutilized portion of financing contracts and Financial Guarantees | - | - | - | - |
| – Due from banks, Central Bank and Other Financial Assets | - | - | - | - |
| | **14** | **(100)** | **374** | **288** |
| **Closing Balance - as at 31 December 2018** | | | | |
| – Financing contracts with customers | **294** | **306** | **669** | **1,269** |
| – Financial Assets at amortised cost | **55** | - | - | **55** |
| – Unutilized portion of financing contracts and Financial Guarantees | - | - | - | - |
| – Due from banks, Central Bank and Other Financial Assets | - | - | - | - |
| | **348** | **306** | **669** | **1,324** |

Impairment charge and provisions held

*RO 000*

| | As per CBO Norms | As per IFRS 9 | Difference |
|---|---|---|---|
| Impairment loss charged to profit and loss account | (221) | (221) | – |
| Provisions required as per CBO norms/held as per IFRS 9 | 1,717* | 1,324 | (393) |
| Gross NPF ratio | 1.63 | 1.63 | – |
| Net NPF ratio | 1.24 | 1.13 | (0.10) |

**Excludes contractual interest reserved for RO 137 thousand.*

The related difference (net of tax) between the existing financing loss impairment computed in accordance with the requirements of AAOIFI and CBO guidelines and the impairment allowance computed under IFRS 9, has not transferred to a financing loss impairment reserve from accumulated losses as of 1 January 2018 and 31 December 2018, as the Window is not a separate legal entity and the requirement is assessed at the overall Bank level.

## 19 Unrestricted investment account holders

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Mudaraba savings account | 4,772 | 4,600 |
| Profit equalisation reserve | 310 | 254 |
| Investment risk reserve | 118 | 93 |
| **Total unrestricted investment account holders** | **5,200** | 4,947 |

There are no restricted investment as at 31 December 2018 (2017: Nil).

Impairment charge and provisions held

The related difference (net of tax) between the existing financing loss impairment computed in accordance with the requirements of AAOIFI and CBO guidelines and the impairment allowance computed under IFRS 9, has not transferred to a financing loss impairment reserve from accumulated losses as of 1 January 2018 and 31 December 2018, as the Window is not a separate legal entity and the requirement is assessed at the overall Bank level.

| | 2018 Percentage | 2017 Percentage |
|---|---|---|
| Unrestricted investment accountholders share | 40% | 40% |
| Mudarib share | 60% | 60% |

The investment risk reserve at 0.5 percent is deducted from customer's share after allocating the Mudarib share of profit as per the approved policy in order to cater against future losses of unrestricted investment accountholders. Investment risk reserve will revert to the investment accountholders as per terms and conditions of Mudaraba contract.

The profit equalisation reserve at 1 percent is the amount Muzn appropriates in excess of the profit to be distributed to unrestricted accountholders before allocating the Mudarib share of income to maintain a certain level of return. Profit equalisation reserve will revert to owner equity and unrestricted investment accountholders.

## 20 Assigned capital

The assigned capital consists of RO 13,500,000 transferred from National Bank of Oman SAOG (31 December 2017: RO 13,500,000).

Notes to the Financial Statements
As at 31 December 2018

## 21 Deferred sales under Murabaha profit

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2018 RO'000 |
|---|---|---|---|
| Deferred sales under Murabaha profit | 33 | 49 | 82 |

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2018 RO'000 |
|---|---|---|---|
| Deferred sales under Murabaha profit | 34 | 52 | 86 |

## 22 Ijarah Muntahiah Bittamleek income

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2018 RO'000 |
|---|---|---|---|
| Income from Ijarah Muntahiah Bittamleek | 5,435 | 8,153 | 13,588 |
| Less : depreciation | (3,627) | (5,440) | (9,067) |
| | 1,808 | 2,713 | 4,521 |

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2017 RO'000 |
|---|---|---|---|
| Income from Ijarah Muntahiah Bittamleek | 5,035 | 7,553 | 12,588 |
| Less : depreciation | (3,385) | (5,078) | (8,463) |
| | 1,650 | 2,475 | 4,125 |

## 23 Diminishing Musharaka income

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2018 RO'000 |
|---|---|---|---|
| Income from Diminishing Musharaka | 317 | 476 | 793 |

| | Self- Financed RO'000 | Jointly Financed RO'000 | 2018 RO'000 |
|---|---|---|---|
| Income from Diminishing Musharaka | 264 | 397 | 661 |

## 24 Return on unrestricted investment accountholders

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Mudarabha savings account | 33 | 33 |

## 25 Return on Wakala accountholders

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Wakala | 1,597 | 1,650 |
| Flex Wakala | 1,722 | 1,378 |
| | 3,319 | 3,028 |

## 26 General and administrative expenses

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Salaries and allowances | 1,331 | 1,420 |
| Rent, rates and taxes | 208 | 219 |
| Publicity | 20 | 46 |
| Management fee to Head Office | 60 | 60 |
| Repair and maintenance | 88 | 83 |
| Legal and professional fees | 5 | 5 |
| Stationery | 12 | 19 |
| Directors' fees | 48 | 53 |
| Travel expenses | 10 | 27 |
| Miscellaneous expenses | 303 | 203 |
| | 2,085 | 2,135 |

## 27 Related party transactions

In the ordinary course of business, Muzn conducts transactions with certain of its Directors, shareholders of the Bank and companies over which they are able to exert significant influence. The aggregate amounts of balances with such related parties are as follows:

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| **Deposits and other accounts** | | |
| Directors, Shari'a Supervisors and shareholders holding less than 10% interest in Muzn | 8,548 | 6,940 |

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| **Financing** | | |
| Directors, Shari'a Supervisors and shareholders holding less than 10% interest in Muzn | 104 | 120 |

The statement of income includes the following amounts in relation to transactions with related parties:

Notes to the Financial Statements
As at 31 December 2018

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| **Remuneration paid to Directors & Shari'a Supervisors Board** | | |
| Chairman | | |
| – remuneration proposed | 8 | 8 |
| – sitting fees paid | 3 | 3 |
| – other expenses paid | 3 | 3 |
| Other Directors | | |
| – remuneration proposed | 17 | 19 |
| – sitting fees paid | 11 | 12 |
| – other expenses paid | 6 | 8 |
| **Management fee payable to conventional banking** | **60** | **60** |

## 28 Contingent liabilities and commitments

### 28.1 Credit related contingent items

The Window is a party to financial instrument with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include standby letters of credit, financial guarantees to third parties, commitments to extend credit and others. The Window's exposure to credit loss in the event of non-performance by the other party to such financial instruments is represented by the contract value or the notional amount of the instrument. However, generally the credit risk on these transactions is lower than the contract value or the notional amount.

The risk involved is essentially the same as the credit risk involved in extending financing facilities and therefore these transactions are subject to the same credit organisation, portfolio maintenance and collateral requirements for customers applying for financing to customers.

The outstanding contract value or the notional amounts of these instruments at 31 December were as follows:

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Letters of credit | - | - |
| Letters of guarantee | 176 | 699 |
| | **176** | **699** |

At the reporting date, outstanding undrawn portion of financing contracts with customers amounted to RO Nil (2017: RO Nil).

The table below analyses the concentration of contingent liabilities by economic sector:

| | 2018 RO'000 | | 2017 RO'000 | |
|---|---|---|---|---|
| Construction | - | 0% | - | 0% |
| Utilities | - | 0% | - | 0% |
| Export trade | - | 0% | - | 0% |
| Government | - | 0% | - | 0% |
| Import trade | - | 0% | - | 0% |
| Transportation | - | 0% | - | 0% |
| Wholesale and retail trade | - | 0% | - | 0% |
| Services | 176 | 100% | 699 | 100% |
| Manufacturing | - | 0% | - | 0% |
| Mining & Quarrying | - | 0% | - | 0% |
| | **176** | **100%** | **699** | **100%** |

### 28.2 Capital and investment commitments

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Contractual commitments for Forward Ijarah | 1,879 | 2,017 |
| Contractual commitments for Diminishing Musharaka | 490 | - |
| | 2,369 | 2,017 |
| Operating lease commitments | 202 | 68,400 |
| Future minimum lease payments: | | |
| Not later than one year | 64 | 20 |
| Later than one year and not later than five years | 138 | 48 |
| Directors' fees | 202 | 68 |

## 29 Financial risk management

The primary objective of risk management is to safeguard the Muzn's resources from the various risks which Muzn faces. The Risk Group comprises of Corporate Credit Risk, Retail Credit Risk, Market Risk and Operational Risk. All risk management functions report to Chief Risk Officer and are independent from Business Units. Muzn has exposure to credit risk, liquidity risk and market risk.

### Credit risk

Credit risk is the risk that Muzn will incur a loss because its customers, clients or counterparties failed to discharge their contractual obligations to Muzn. Muzn manages and controls credit risk by setting internal limits on the amount of risk it is willing to accept for individual counterparties and groups (single obligors) and industry sectors in line with the guidelines of Central Bank of Oman.

### Credit risk management

To manage the level of credit risk, Muzn deals with counter-parties of good credit. Corporate Credit Committee of the Board is the final credit approving authority of Muzn which is mainly responsible for approving all credit proposals beyond the authority level of the management. The Management Credit Committee ("MCC") is the management decision making body which is empowered to consider all credit related issues upto certain limits.

### Credit risk mitigation policies

Muzn manages, limits and controls concentrations of credit risk – in particular, with respect to individual counterparties and groups, and industries and countries. Muzn structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored and reviewed periodically by the Management Credit Committee and Board Risk Committee.

To facilitate risk mitigation Moody's, S&P and Fitch ratings have also been set up and are also being used as guidelines to ensure portfolio diversification in terms of sovereign risk ratings and geographical exposure. These limits are approved by the Board. Retail financing is strictly in accordance with the CBO guidelines.

The analysis of financing portfolio is provided below. It is pertinent to mention that the financing portfolio consists of all standard accounts and there is no impairment in the portfolio.

With the recent adoption of IFRS 9 standards, credit risk management has been enhanced further where more attributes have been taken into consideration, including but not limited, identifying existing emerging key risks related to industry, economics, transaction structure, terms and condition of the payments etc in assessment of ECL.

Incorporating forward looking information increases the level of judgement as to how changes in these macroeconomic factors will affect the Expected Credit Loss (ECL) applicable to the stage 1 and stage 2 exposures which are considered as performing. The methodologies and assumptions involved, including any forecasts of future economic conditions, are reviewed periodically. The assessment of significant increase in credit risk and the calculation of ECL both incorporate forward-looking information.

Notes to the Financial Statements
As at 31 December 2018

### (a) Geographical concentrations

All the financial asset and financial liabilities reported in the balance sheet and all the items reported in off balance are based in Sultanate of Oman.

### (b) Customer concentrations

| 31 December 2018 | Due from Banks and financial institutions RO'000 | Financial assets at amortised cost RO'000 | Deferred sales under Murabaha RO'000 | Ijarah Muntahia Bittamleek RO'000 |
|---|---|---|---|---|
| **On Assets** | | | | |
| Retail | - | - | 1,254 | 61,709 |
| Corporate | 5,335 | 8,248 | 315 | 22,454 |
| | **5,335** | **8,248** | **1,569** | **84,163** |

| 31 December 2018 | Diminishing Musharaka RO'000 | Forward Ijarah RO'000 | Service Ijarah RO'000 |
|---|---|---|---|
| **On Assets** | | | |
| Retail | 1,770 | 3,813 | 11 |
| Corporate | 24,355 | 884 | - |
| | **26,125** | **4,697** | **11** |

| 31 December 2018 | Current accounts RO'000 | Wakala accounts RO'000 | Due to banks and financial institutions RO'000 | Unrestricted Investment Accountholders RO'000 |
|---|---|---|---|---|
| **On Liabilities** | | | | |
| Retail | 1,306 | 15,745 | - | 5,200 |
| Corporate | 4,639 | 87,771 | 10,060 | - |
| | **5,945** | **103,516** | **10,060** | **5,200** |

| 31 December 2017 | Due from Banks and financial institutions RO'000 | Financial assets at amortised cost RO'000 | Deferred sales under Murabaha RO'000 | Ijarah Muntahia Bittamleek RO'000 |
|---|---|---|---|---|
| **On Assets** | | | | |
| Retail | - | - | 1,335 | 60,945 |
| Corporate | 19,932 | 5,476 | 330 | 24,507 |
| | **19,932** | **5,476** | **1,665** | **85,452** |

| 31 December 2017 | Diminishing Musharaka RO'000 | Forward Ijarah RO'000 |
|---|---|---|
| **On Assets** | | |
| Retail | 546 | 3,271 |
| Corporate | 10,462 | 1,385 |
| | **11,008** | **4,656** |

| 31 December 2017 | Current accounts RO'000 | Unrestricted investment accountholders RO'000 |
|---|---|---|
| **On Liabilities** | | |
| Retail | 1,135 | 16,546 |
| Corporate | 4,141 | 97,910 |
| | **5,276** | **114,456** |

### (c) Economic sector concentrations

| | Assets | | | | |
|---|---|---|---|---|---|
| | Deferred sales under Murabaha RO'000 | Ijarah Muntahiah Bittamleek RO'000 | Diminishing Musharaka RO'000 | Forward Ijarah RO'000 | Service Ijarah RO'000 |
| 31 December 2018 | | | | | |
| Personal | 1,254 | 61,708 | 1,770 | 3,813 | 11 |
| Construction | 21 | 15,319 | 11,631 | 884 | - |
| Manufacturing | 78 | 1,313 | 10,029 | - | - |
| Trade | 81 | 38 | 342 | - | - |
| Services | 135 | 5,785 | 2,353 | - | - |
| | **1,569** | **84,163** | **26,125** | **4,697** | **11** |

| | Liabilities | | |
|---|---|---|---|
| | Current accounts RO'000 | Wakala accounts RO'000 | Savings accounts RO'000 |
| 31 December 2018 | | | |
| Personal | 5,945 | 103,516 | 5,200 |
| Construction | - | - | - |
| Manufacturing | - | - | - |
| Trade | - | - | - |
| Services | - | - | - |
| | **5,945** | **103,516** | **5,200** |

Notes to the Financial Statements
As at 31 December 2018

| | Assets | | | | Liabilities | |
|---|---|---|---|---|---|---|
| | Deferred sales under Murabaha RO'000 | Ijarah Muntahiah Bittamleek RO'000 | Diminishing Musharaka RO'000 | Forward Ijarah RO'000 | Current accounts RO'000 | Wakala and Savings deposit RO'000 |
| 31 December 2017 | | | | | | |
| Personal | 1,334 | 60,944 | 546 | 3,271 | 5,276 | 114,456 |
| Construction | 11 | 16,714 | 10,206 | 1,384 | - | - |
| Manufacturing | - | 1,847 | 100 | - | - | - |
| Trade | 232 | - | - | - | - | - |
| Services | 88 | 5,947 | 156 | - | - | - |
| | 1,665 | 85,452 | 11,008 | 4,655 | 5,276 | 114,456 |

Impairment assessment (Policy applicable from 1 January 2018)

Definition of default and cure

The Window considers a financial instrument defaulted and therefore Stage 3 (credit-impaired) for ECL calculations in all cases when the borrower becomes 90 days past due on its contractual payments. The Window considers treasury and interbank balances defaulted and takes immediate action when the required intraday payments are not settled by the close of business as outlined in the individual agreements.

As a part of a qualitative assessment of whether a customer is in default, the Window also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Internal rating of the borrower indicating default or near-default
- The borrower requesting emergency funding from the Window
- The borrower having past due liabilities to public creditors or employees
- The borrower is deceased
- A material decrease in the underlying collateral value where the recovery of the financing is expected from the sale of the collateral
- A material decrease in the borrower's turnover or the loss of a major customer
- A covenant breach not waived by the Window
- The debtor (or any legal entity within the debtor's group) filing for bankruptcy application/protection • Debtor's listed debt or equity suspended at the primary exchange because of rumours or facts about financial difficulties

It is the Window's policy to consider a financial instrument as 'cured' and therefore re-classified out of Stage 3 when none of the default criteria have been present for at least six consecutive months. The decision whether to classify an asset as Stage 2 or Stage 1 once cured depends on the updated credit grade, at the time of the cure, and whether this indicates there has been a significant increase in credit risk compared to initial recognition.

Incorporation of forward-looking information

The Window 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. Based on consideration of a variety of external actual and forecast information, the Window formulates a fundamental view of the future direction of relevant economic variables as well as a reasonable range of possible scenarios.

Given the nature of the Window's exposures and availability of historical statistically reliable information, the Window derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Moody's for each rating category.

Economic variable assumptions

The method applied for determination of macroeconomic scenarios and their probabilities is a hybrid approach that combines deterministic forecast / modelling with analysis of stochastic distribution to get the alternative economic conditions and their probabilities.

The major assumptions and methodological choices can be summarised in a following set of steps:

1. Despite the fact that oil price was not chosen as an explanatory variable during statistical optimisation of variable selection, the business acumen as well as correlation analysis suggest that it is a major driving force in determination of GDP and real interest rate as defined by the World Bank (GDP deflator is highly affected by oil price as oil manufacturing is responsible for a vast portion of GDP volume in Oman).
2. The base scenario was created on the assumption of stabilisation of oil price at the level of 54 USD/barrel for Brent oil.
3. The alternative scenarios were constructed based on deviations from the base trajectory of oil price taking into account:
    a. historical volatility of changes in oil prices (28% standard deviation of annual relative price changes),
    b. size of the detachment equal to plus/minus 0,87 standard deviation from the base scenario as an approximate representation of 33,33% probability of alternative (adverse and favourable) scenarios,
    c. the time dynamics of the variable was based on assumption of normal distribution of annual changes of oil prices with some mean reverting characteristics and respective time scaling (standard deviation times square root of time) with the signs (-/+) in line with the character of the scenario (adverse / favourable).
4. GDP and real interest rate were forecasted deterministically based on their reciprocal dependencies and their relationship (with appropriate time lags) to oil price changes assuming mid-prices of Brent oil under given scenario as obtained through the process described in 3.
5. GDP per capita was predicted through regression to corresponding GDP changes as estimated for a given scenario and assumed lowering pace of population growth not dependent on the scenario in question.

The following tables set out the key drivers of expected loss and the assumptions used for the Window's base case estimate, ECLs based on the base case, plus the effect of the use of multiple economic scenarios as at 31 December 2018.

| Key drivers | ECL scenario and assigned weightage | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|
| Real Finance Rate | Base scenario | 7.6% | 7.6% | 7.6% | 7.6% |
| | Upside scenario | 3.7% | 5.5% | 6.3% | 6.8% |
| | Downside scenario | 13.9% | 11.8% | 10.4% | 9.4% |
| GDP | Base scenario | 5.1% | 4.3% | 4.3% | 4.3% |
| | Upside scenario | 6.8% | 7.2% | 6.7% | 6.7% |
| | Downside scenario | 3.3% | 1.4% | 1.7% | 1.7% |
| GDP per capita | Base scenario | 0.1% | -0.3% | 0.2% | 0.7% |
| | Upside scenario | 2.3% | 3.2% | 3.2% | 3.7% |
| | Downside scenario | -2.0% | -3.7% | -2.9% | -2.3% |

Corporate and small business lending

For corporate and investment banking loans, the borrowers are assessed by specialised credit risk employees of the Bank. The credit risk assessment is based on a credit scoring model that takes into account various historical, current and forward-looking information such as:

As a part of a qualitative assessment of whether a customer is in default, the Window also considers a variety of instances that may indicate unlikeliness to pay. When such events occur, the Bank carefully considers whether the event should result in treating the customer as defaulted and therefore assessed as Stage 3 for ECL calculations or whether Stage 2 is appropriate. Such events include:

- Historical financial information together with forecasts and budgets prepared by the client. This financial information includes realised and expected results, solvency ratios, liquidity ratios and any other relevant ratios to measure the client's financial performance. Some of these indicators are captured in covenants with the clients and are, therefore, measured with greater attention.
- Any publicly available information on the clients from external parties. This includes external rating grades issued by rating agencies, independent analyst reports, publicly traded bond or CDS prices or press releases and articles.
- Any macro-economic or geopolitical information, e.g., GDP growth relevant for the specific industry and geographical segments where the client operates.
- Any other objectively supportable information on the quality and abilities of the client's management relevant for the company's performance.
    - The complexity and granularity of the rating techniques varies based on the exposure of the Bank and the complexity and size of the customer. Some of the less complex small business loans are rated within the Bank's models for retail products.

Notes to the Financial Statements
As at 31 December 2018

### Consumer lending and retail mortgages

Consumer lending comprises secured personal financing and overdrafts. These products along with retail mortgages and some of the less complex small business lending are rated by an automated scorecard tool primarily driven by days past due. Other key inputs into the models are:

- Consumer lending products: use of limits and volatility thereof, GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing
- Retail mortgages: GDP growth, unemployment rates, changes in personal income/salary levels based on records of current accounts, personal indebtedness and expected interest repricing

### Exposure at default

The exposure at default (EAD) represents the gross carrying amount of the financial instruments subject to the impairment calculation, addressing both the client's ability to increase its exposure while approaching default and potential early repayments too.

To calculate the EAD for a Stage 1 financing, the Window assesses the possible default events within 12 months for the calculation of the 12mECL. However, if a Stage 1 financing that is expected to default in the 12 months from the balance sheet date and is also expected to cure and subsequently default again, then all linked default events are taken into account. For Stage 2, Stage 3 and POCI financial assets, the exposure at default is considered for events over the lifetime of the instruments.

The Window determines EADs by modelling the range of possible exposure outcomes at various points in time, corresponding the multiple scenarios. The IFRS 9 PDs are then assigned to each economic scenario based on the outcome of Window's models.

### Loss given default

For corporate and investment banking financial instruments, LGD values are assessed at least every twelve months by account managers and reviewed and approved by the Window's specialised credit risk department. The credit risk assessment is based on a standardised LGD assessment framework that results in a certain LGD rate. These LGD rates take into account the expected EAD in comparison to the amount expected to be recovered or realised from any collateral held.

The Window segments its retail lending products into smaller homogeneous portfolios, based on key characteristics that are relevant to the estimation of future cash flows. The applied data is based on historically collected loss data and involves a wider set of transaction characteristics (e.g., product type, wider range of collateral types) as well as borrower characteristics. Further recent data and forward-looking economic scenarios are used in order to determine the IFRS 9 LGD rate for each group of financial instruments. When assessing forward-looking information, the expectation is based on multiple scenarios. Examples of key inputs involve changes in, collateral values including property prices for mortgages, commodity prices, payment status or other factors that are indicative of losses in the bank.

The Window estimates regulatory and IFRS 9 LGDs on a different basis. Under IFRS 9, LGD rates are estimated for the Stage 1, Stage 2, Stage 3 and POCI IFRS 9 segment of each asset class. The inputs for these LGD rates are estimated and, where possible, calibrated through back testing against recent recoveries. These are repeated for each economic scenario as appropriate.

### Significant Increase in Credit Risk

The Window continuously monitors all assets subject to ECLs. In order to determine whether an instrument or a portfolio of instruments is subject to 12mECL or LTECL, the Window assesses whether there has been a significant increase in credit risk since initial recognition.

The Window also applies a secondary qualitative method for triggering a significant increase in credit risk for an asset, such as moving a customer/facility to the watch list, or the account becoming forborne. In certain cases, the Window may also consider that events set out below are a significant increase in credit risk as opposed to a default. Regardless of the change in credit grades, if contractual payments are more than 30 days past due, the credit risk is deemed to have increased significantly since initial recognition.

a. Inadequate or unreliable financial or other information such as unavailability of audited financial statements within 120 days from end of accounting period.
b. Delay in documentation execution over 35 days from limit set up due to disputes with customers.
c. Borrower is subject to litigation by third parties that may have a significant impact on his financial position.
d. Frequent changes in key senior management personnel without acceptable successors or professional management.
e. Intra Group transfer of funds without underlying transactions beyond 50% of Tangible Net Worth.
f. Deferment/delay in the date for commencement of commercial operations by more than one year except in Government projects or delays are due to Government approvals.
g. Modifications of terms resulting in concessions granted to the borrower (after examining the cash flows of the borrower/financial position/ability to repay) including extension of moratorium, deferment of payment, waiver of covenants etc. This requirement shall be in conformity to the restructuring guidelines issued by CBO from time to time.
h. A fall of 25% or more in the turnover or in the EBIT as compared to the previous year except in the case of change in business model/one of material events.
i. A fall in Debt Service coverage ratio to below 1 except in cases which have acceptable external credit support.
j. Rating downgrade by 3 notches for ratings from R1 to R4 and 2 notches downgrade for R5 and R6.
k. Erosion in net worth by more than 20% compared to previous year coupled with increase in leverage by 1.5 times.

### Model risk management:

The Window has utilised models in many of its financial and business activities from underwriting a credit facility to reporting expected loss under the IFRS9 accounting standards.

To manage the model risks, the Window has implemented the IFRS 9 Governance Framework (the Framework). The Framework is a bank wide policy and is applicable to all models of the Bank. According to the Framework, all internally or externally (vendor based) developed risk quantification models that directly affect the financial reporting on Expected Loss (EL) and Lifetime Expected Loss (LEL) require independent validation.

The Framework establishes a systematic approach to manage the development, validation, approval, implementation and on-going use of the models. It sets out an effective management structure with clearly defined roles and responsibilities, policies and controls for managing model risk. The Framework is reviewed on a regular basis to ensure it meets regulatory standards and international practices. Any major change to the Framework must be approved by the Board of Directors or the BRC.

The Window has a practice of doing independent model validation which provides recommendation to approve the use of the new risk quantification / valuation models. In addition to new model validation, it also evaluates the performance of existing models through an annual validation process. The independency of the team will serve as an effective second line of defense for the Window in terms of usage of models.

### Liquidity risk

Liquidity risk is the potential inability to meet Muzn's liabilities as they become due. It arises when Muzn is unable to generate cash to cope with a decline in deposits or increase in assets.

Muzn's liquidity risk management is governed by the Treasury Risk Policy document approved by the Board of Directors as well as the provisions of the relevant CBO guidelines on liquidity risk management through cash flow approach. The liquidity management does not only measure the liquidity position of the Bank on an going basis but also examine how funding requirement are likely to evolve under various scenarios.

Muzn monitors its liquidity risk through cash flow approach and stock approach. Under the cash flow approach, Muzn generates Maturity of Assets and Liabilities (MAL) report which captures all the maturing assets and liabilities into various pre-set time buckets ranging from one month to over five years. The mismatches in various time buckets indicate liquidity gap and Muzn strictly adheres to the CBO set limit of cumulative liabilities (outflows) on mismatches (liquidity gaps) in time buckets up to one year. In addition, Muzn has also set up internal limit on mismatches in time buckets beyond one year.

Treasury department of Muzn controls and monitors the liquidity risk and ensures that Muzn is not exposed to undue liquidity risk and at the same time makes optimum use of its funds. The middle office in Credit risk division also monitors the liquidity position of Muzn and provides the liquidity gap to Treasury Department to meet liquidity gaps.

The Central Bank of Oman has issued guidelines on the implementation of Basel III liquidity framework which are Liquidity Coverage Ratio (LCR) and Net Stable Funding (NSFR). The Liquidity coverage ratio (LCR) is a short time ratio designed to increase resilience against a liquidity shortage of up to 30 days. The LCR is computed as per CBO requirement under the circular BM1127 (BASEL III: Framework on Liquidity coverage ratio and LCR disclosure standards). It is required to maintain a minimum required level of 100% effective from January 1, 2019.

The Net Stable Funding Ratio (NSFR) is a longer term structural ratio designed to address liquidity mismatches and reduce funding risk over a one year horizon. It is required to maintain a minimum ratio of 100% as per the regulatory guidance. The residual maturity profile of the assets, liabilities and equity at 31 December 2018 is as follows:

| 31 December 2018 | Due on demand and up to 30 days RO'000 | More than 1 month to 6 months RO'000 | More than 6 months to 12 months RO'000 | More than 1 year to 5 years RO'000 | Over 5 years RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|
| Cash and balances with Central Bank of Oman | 7,136 | 1,553 | 548 | 365 | 618 | 10,220 |
| Due from banks and financial institutions | 5,335 | - | - | - | - | 5,335 |
| Financial assets at amortised cost | 3,550 | - | - | 963 | 3,735 | 8,248 |
| Deferred sales under Murabaha | 155 | 394 | 227 | 607 | 186 | 1,569 |
| Ijarah Muntahiah Bittamleek – net | 724 | 5,118 | 5,135 | 16,437 | 56,749 | 84,163 |
| Diminishing Musharaka | 222 | 2,367 | 2,432 | 11,854 | 9,250 | 26,125 |
| Forward Ijarah | 601 | 287 | 546 | 3,263 | - | 4,697 |
| Service Ijarah | - | 1 | 1 | 4 | 5 | 11 |
| Property and equipment (net) | - | - | - | - | 421 | 421 |
| Other assets | 342 | - | - | - | - | 342 |
| Total assets | 18,065 | 9,720 | 8,889 | 33,493 | 70,964 | 141,131 |

| 31 December 2018 | Due on demand and up to 30 days RO'000 | More than 1 month to 6 months RO'000 | More than 6 months to 12 months RO'000 | More than 1 year to 5 years RO'000 | Over 5 years RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|
| Current accounts | 1,189 | 2,081 | 1,190 | - | 1,485 | 5,945 |
| Wakala accounts | 11,452 | 51,819 | 17,634 | 4,607 | 18,004 | 103,516 |
| Due to banks and financial institutions | 10,060 | - | - | - | - | 10,060 |
| Other liabilities | 4,641 | - | - | - | - | 4,641 |
| Unrestricted investment account holders | 477 | 954 | 954 | 1,431 | 1,384 | 5,200 |
| Owner's equity | - | - | - | - | 11,769 | 11,769 |
| Total liabilities and unrestricted investment account holders and owners' equity | 27,819 | 54,854 | 19,778 | 6,038 | 32,642 | 141,131 |



Notes to the Financial Statements
As at 31 December 2018

The maturity profile of the assets, liabilities and equity at 31 December 2017 is as follows

| 31 December 2017 | Due on demand and up to 30 days RO'000 | More than 1 month to 6 months RO'000 | More than 6 months to 12 months RO'000 | More than 1 year to 5 years RO'000 | Over 5 years RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|
| Cash and balances with Central Bank of Oman | 2,207 | 1,395 | 454 | 547 | 666 | 5,269 |
| Due from banks and financial institutions | 19,932 | - | - | - | - | 19,932 |
| Financial assets at amortised cost | 3,550 | - | 1,926 | - | - | 5,476 |
| Deferred sales receivables | 52 | 292 | 230 | 1,034 | 57 | 1,665 |
| Ijarah Muntahiah Bittamleek – net | 1,142 | 4,361 | 4,464 | 34,055 | 41,430 | 85,452 |
| Diminishing Musharaka | 82 | 1,063 | 870 | 7,152 | 1,841 | 11,008 |
| Forward Ijarah | 231 | 246 | 572 | 3,607 | - | 4,656 |
| Property and equipment (net) | - | - | - | - | 599 | 599 |
| Other assets | 247 | - | - | - | - | 247 |
| Owner's equity | 27,443 | 7,357 | 8,516 | 46,395 | 44,593 | 134,304 |
| Current accounts | 5,276 | - | - | - | - | 5,276 |
| Other liabilities | 3,481 | - | - | - | - | 3,481 |
| Unrestricted investment account holders | 18,625 | 46,233 | 14,739 | 13,872 | 20,987 | 114,456 |
| Other assets | - | - | - | - | 11,091 | 11,091 |
| Total liabilities and unrestricted investment accountholders and owners' equity | 27,382 | 46,233 | 14,739 | 13,872 | 32,078 | 134,304 |

## Liquidity coverage ratio

| | Total unweighted value (average) RO'000 | Total weighted value (average) RO'000 |
|---|---|---|
| **High quality liquid assets** | - | 15,755 |
| Total High Quality Liquid Assets (HQLA) | - | 15,755 |
| **Cash outflows** | | |
| **Retail deposits and deposits from small business customers of which:** | **17,518** | **1,493** |
| Stable deposits | 5,174 | 259 |
| Less stable deposits | 12,344 | 1,234 |
| Unsecured wholesale funding, of which: | | |
| Operational deposits (all counterparties) and deposits in networks of cooperative banks | 58,372 | 26,428 |
| Additional requirements, of which Credit and liquidity facilities | - | - |
| Other contingent funding obligations | 165 | 32 |
| Total cash outflows | 76,055 | 27,953 |

| | Total Unweighted Value (average) RO'000 | Total weighted value (average) RO'000 |
|---|---|---|
| **Cash outflows** | | |
| Inflows from fully performing exposures | 14,865 | 14,311 |
| Other cash inflows | 1,128 | 1,128 |
| **Total cash inflows** | 15,993 | 15,439 |
| | | |
| Total high quality liquid assets | | 15,755 |
| Total net cash outflows | | 12,514 |
| **Liquidity coverage ratio (%)** | | 125.90 |

## Market risk

Market risk includes currency risk, profit rate risk and equity price risk

(a) Currency risk

Muzn is exposed to currency risk through its transactions in foreign currencies. The major foreign currency to which Muzn is exposed is the US Dollar which is effectively pegged to Rial Omani. Muzn finances a significant portion of its financial assets in the same currencies as the relevant measurement currencies to mitigate its foreign currency risk.

(b) Profit rate risk

Profit rate risk (PRR) is the risk that Muzn will incur a financial loss as a result of mismatch in the profit rates on assets & investment accountholders. The profit distribution to investment accountholders in based on Profit Sharing Agreements. Therefore, Muzn is not subject to any significant PRR. However, the profit sharing agreements will result in displaced commercial risk when Muzn's results do not allow it to distribute profits in line with the market rates.

Muzn has a detailed Profit Distribution Policy in place which details the process and management of Profit Distribution, including setting up of Profit Equalization & Investment Risk Reserve. The responsibility of profit rate risk management rests with Muzn's Asset and Liability Management Committee (ALCO).

Profit rate risk is managed by monitoring the sensitivity of the Bank's financial assets and liabilities to various standardized profit rate shocks. Standardised shocks include a 100 basis point and 200 basis point parallel shifts in yield curves that are considered on a monthly basis. The impact of these shocks is analysed in the context of its impact on Earnings and Economic Value. The impact is compared against internal limits which have been formulated in line with the Central Bank of Oman and Basel Committee guidelines. The analysis is regularly reviewed by the Management and Board Risk Committee.

Earning impact of 200 basis points parallel shift in profit rate is provided below:

| As at December 2018 | 200 bps increase | 200 bps decrease |
|---|---|---|
| Earnings impact - RO'000s | 500 | (500) |





Profit rate sensitivity gap

Sensitivity to profit rates arises from mismatches in the period to re-pricing of assets and that of the corresponding liability. Muzn manages these mismatches by following policy guidelines and reduces risk by matching the re-pricing of assets and liabilities.

| 31 December 2018 | Effective average profit rate % | Due on demand and within 6 months RO'000 | Due within 7 to 12 months RO'000 | Due within 1 to 5 years RO'000 | Due after 5 years RO'000 | Non-profit bearing RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Banks of Oman | N/A | - | - | - | - | 10,220 | 10,220 |
| Due from banks and financial Institutions | 2.4% | 5,000 | - | - | - | 335 | 5,335 |
| Financial assets at amortised cost | 5.1% | - | - | 4,513 | 3,735 | - | 8,248 |
| Deferred sales under Murabaha | 5.1% | 549 | 227 | 607 | 186 | - | 1,569 |
| Ijarah Muntahia Bittamleek – net | 5.3% | 5,842 | 5,135 | 16,437 | 56,749 | - | 84,163 |
| Diminishing Musharaka | 5.8% | 2,589 | 2,432 | 11,854 | 9,250 | - | 26,125 |
| Forward Ijarah | N/A | - | - | - | - | 4,697 | 4,697 |
| Service Ijarah | 6.0% | 1 | 1 | 4 | 5 | - | 11 |
| Property and equipment- net | N/A | - | - | - | - | 421 | 421 |
| Other assets | N/A | - | - | - | - | 342 | 342 |
| **Total assets** | | 13,981 | 7,795 | 33,415 | 69,925 | 16,015 | 141,131 |
| Current accounts | N/A | - | - | - | - | 5,945 | 5,945 |
| Wakala accounts | 2.3% | 63,271 | 17,634 | 4,607 | 18,004 | - | 103,516 |
| Due from banks and financial Institutions | 2.3% | 10,060 | - | - | - | - | 10,060 |
| Other liabilities | N/A | - | - | - | - | 4,641 | 4,641 |
| Unrestricted investment account holders | 0.7% | 1,431 | 954 | 1,431 | 1,384 | - | 5,200 |
| Owners' equity | N/A | - | - | - | - | 11,769 | 11,769 |
| **Total liabilities and owners' equity** | | 74,762 | 18,588 | 6,038 | 19,388 | 22,355 | 141,131 |
| **On-balance sheet gap** | | (60,781) | (10,793) | 27,377 | 50,537 | (6,340) | - |
| **Cumulative profit sensitivity gap** | | (60,781) | (71,574) | (44,197) | 6,340 | - | - |

**Notes to the Financial Statements**
As at 31 December 2018

| 31 December 2017 | Effective average profit rate % | Due on demand and within 6 months RO'000 | Due within 7 to 12 months RO'000 | Due within 1 to 5 years RO'000 | Due after 5 years RO'000 | Non-profit bearing RO'000 | Total RO'000 |
|---|---|---|---|---|---|---|---|
| Cash and balances with Central Bank of Oman | N/A | - | - | - | - | 5,269 | 5,269 |
| Due from banks and financial Institutions | 1.3% | 19,931 | - | - | - | 1 | 19,932 |
| Financial assets at amortised cost | 5.0% | 3,550 | - | 1,926 | - | - | 5,476 |
| Deferred sales under Murabaha | 4.7% | 344 | 230 | 1,034 | 57 | - | 1,665 |
| Ijarah Muntahia Bittamleek – net | 5.3% | 5,503 | 4,464 | 34,055 | 41,430 | - | 85,452 |
| Diminishing Musharaka | 5.3% | 1,145 | 870 | 7,152 | 1,841 | - | 11,008 |
| Forward Ijarah | N/A | - | - | - | - | 4,656 | 4,656 |
| Property and equipment – net | N/A | - | - | - | - | 599 | 599 |
| Other asset | N/A | - | - | - | - | 247 | 247 |
| **Total assets** | | 30,473 | 5,564 | 44,167 | 43,328 | 10,772 | 134,304 |
| Current accounts | N/A | - | - | - | - | 5,276 | 5,276 |
| Other liabilities | N/A | - | - | - | - | 3,481 | 3,481 |
| Unrestricted investment account holders | 2.4% | 64,858 | 14,739 | 13,872 | 20,640 | 347 | 114,456 |
| Owners' equity | N/A | - | - | - | - | 11,091 | 11,091 |
| **Total liabilities and owners' equity** | | 64,858 | 14,739 | 13,872 | 20,640 | 20,195 | 134,304 |
| **On-balance sheet gap** | | (34,385) | (9,175) | 30,295 | 22,688 | (9,423) | - |
| **Cumulative profit sensitivity gap** | | (34,385) | (43,560) | (13,265) | 9,423 | - | - |

c) Equity risk

Currently, Muzn is not exposed to any Equity risk.

Operational risk

Muzn has adopted the Basic Indicator Approach under Basel II for the purpose of measuring capital charge for Operational Risk. The approach requires Muzn to provide 15% of the average three years gross annual income as capital charge for operational risk.

## 30 Capital risk management

Muzn manages its capital to ensure that it will be able to continue as a going concern while maximising the return to shareholders within acceptable risk return framework. Muzn's overall strategy remains the same as applicable for Head Office.

The capital adequacy for Muzn is set out as below:

| | 2018 RO'000 | 2017 RO'000 |
|---|---|---|
| Assigned capital | 13,500 | 13,500 |
| Accumulated losses | (1,731) | (2,409) |
| Tier I capital | 11,769 | 11,091 |
| Excepted Credit Losses | 601 | 913 |
| Tier II capital | 601 | 913 |
| Total capital available | 12,370 | 12,004 |
| Risk weighted assets (RWA) | | |
| Credit risk | 92,479 | 73,071 |
| Market risk | 4 | 3 |
| Operational risk | 4,988 | 4,572 |
| **Total RWA** | 97,471 | 77,646 |
| Capital ratios | | |
| **Total capital ratio** | 12.7% | 15.5% |
| **Total Tier I ratio** | 12.1% | 14.3% |

## 31 Segmental information

Muzn is organised into three main business segments:

1) Retail banking – incorporating private customer current accounts, savings, deposits, deferred sales under Murabaha, Ijarah Muntahia Bittamleek, Forward Ijarah and Diminishing Musharaka.
2) Corporate banking – incorporating corporate customer current accounts, savings, deposits, deferred sales under Murabaha, Diminishing Musharaka, Ijarah Muntahia Bittamleek and Forward Ijarah.
3) Treasury and investments

Other operations comprise investment management and institutional finance neither of which constitutes a separately reportable segment.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the statement of financial position, but exclude items such as taxation and deposits.

Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis.

Segment assets and liabilities comprise operating assets and liabilities, being the majority of the statement of financial position, but exclude items such as taxation and deposits.

Internal charges and transfer pricing adjustments have been reflected in the performance of each business. Revenue sharing agreements are used to allocate external customer revenues to a business segment on a reasonable basis.

| At 31 December 2018 | Retail banking RO'000 | Corporate banking RO'000 | Treasury and investments RO'000 | Other RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Segment operating revenues | 3,133 | 2,263 | 715 | - | 6,111 |
| Other revenues | 65 | 138 | 83 | 46 | 332 |
| Segment operating revenues | 3,198 | 2,401 | 798 | 46 | 6,443 |
| Profit expenses | (369) | (2,983) | (131) | (81) | (3,564) |
| Net operating income | 2,829 | (582) | 667 | (35) | 2,879 |
| **Segment cost** | | | | | |
| Operating expenses including depreciation | (897) | (180) | (80) | (1,119) | (2,276) |
| Impairment for finances net of allowance for provision | (10) | (226) | 15 | - | (221) |
| Net Profit for the year | 1,922 | (988) | 602 | (1,154) | 382 |
| Gross segment assets | 70,175 | 48,832 | 22,686 | 763 | 142,456 |
| Less: Impairment allowance | (475) | (795) | (55) | - | (1,325) |
| **Segment assets** | **69,700** | **48,037** | **22,631** | **763** | **141,131** |
| **Segment liabilities** | **21,823** | **92,410** | **21,829** | **5,069** | **141,131** |

| At 31 December 2017 | Retail banking RO'000 | Corporate banking RO'000 | Treasury and investments RO'000 | Other RO'000 | Total RO'000 |
|---|---|---|---|---|---|
| Segment operating revenues | 2,841 | 2,030 | 141 | - | 5,012 |
| Other revenues | 70 | 76 | 268 | 35 | 449 |
| Segment operating revenues | 2,911 | 2,106 | 409 | 35 | 5,461 |
| Profit expenses | (300) | (2,760) | - | (81) | (3,141) |
| Net operating income | 2,611 | (654) | 409 | (46) | 2,320 |
| **Segment cost** | | | | | |
| Operating expenses including depreciation | (963) | (246) | (84) | (1,117) | (2,410) |
| Impairment for finances net of allowance for provision | 23 | 10 | - | - | 33 |
| Net Profit for the year | 1,671 | (890) | 325 | (1,163) | (57) |
| Gross segment assets | 67,878 | 37,321 | 29,592 | 846 | 135,637 |
| Less: Impairment allowance | (697) | (636) | - | - | (1,333) |
| **Segment assets** | **67,181** | **36,685** | **29,592** | **846** | **134,304** |
| **Segment liabilities** | **17,334** | **102,051** | **11,091** | **3,828** | **134,304** |

## 32 Corresponding figures

During the current year, the Bank reclassified income from fixed income investments from Investment income to Income from jointly financed assets. The above reclassifications have resulted in changes as presented below for the comparative figures of 2017 to maintain consistency.

| | 2017 (as previously reported) OMR '000 | Reclassification | 2017 (regrouped) OMR '000 |
|---|---|---|---|
| Income from jointly financed assets | 5,013 | 227 | 5,240 |
| Other operating income | 449 | (227) | 222 |
| **Total** | **5,462** | **–** | **5,462** |

NBO's Branch Network

**60** Branches in Oman

**17** Sadara Centres

**6** Muzn Islamic Banking Branches

**2** Branches in UAE

| Branch | Telephone No | |
|---|---|---|
| Azaiba - HO Branch | 24778190 | 24778355 |

| Muscat South Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Hamriya | 24831520 | 24833792 |
| Corniche | 24715103 | 24714245 |
| Wattaya | 24568244 | 24560585 |
| Qurriat | 24846100 | 24846415 |
| MAF | 24565561 | 24566860 |
| Qurum | 24560050 | 24562615 |
| CBD | 24778350 | 24778351 |
| Amerat | 24875766 | 24877379 |
| Shati Qurum | 24607161 | 24607687 |

| Muscat North Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Al Mawaleh | 24511164 | 24511165 |
| Bousher | 24587291 | 24587294 |
| Ministry Of Health | 24692310 | 24692309 |
| Al Khoudh | 24537950 | 24537951 |
| Seeb Town | 24420441 | 24423511 |
| Maabella | 24453314 | 24455957 |
| Ghoubra | 24497229 | 24491062 |
| Bukha | 26828014 | |
| Muscat International Airport | 24356922 | 24356923<br>24356926 |
| Ministry of Education | 24521448 | 24510007 |
| Khasab | 26731442 | 26730467 |
| Al Khuwair | 24486441 | 24486481 |
| Sultan Qaboos University | 24446768 | 24446556 |

| Dakhliya & Dhahira Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Nizwa | 25410043 | 25410072 |
| Buraimi | 25653037 | |
| Ibri | 25691161 | |
| Bahla | 25363613 | 25363786 |
| Sumail | 25350355 | |
| Fanja | 25361190 | |
| Al Hamra | 25422008 | |
| FIRQ | 25432149 | |
| Dhank | 25676603 | |
| Araqi | 25694342 | |

| Batina Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Afi | 26780972 | 26781562 |
| Rustaq | 26878334 | 26878332 |
| Sohar Al Hambar | 26859105 | 26859104 |
| Shinas | 26748394 | 26747663 |
| Barka | 26882007 | |
| Khabourah | 26802380 | 26805155 |
| Musna | 26870182 | 26871118 |
| Saham | 26855299 | 26855146 |
| Bidaya | 26709340 | 26709240 |
| Sohar Ind. | 26755878 | 26755875 |
| Al Suwaiq | 26860518 | |
| Sohar | 26840234 | 26843780 |
| Liwa | 26762073 | 26762075 |

| Sharqiya Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Ibra | 25570144 | 25570015 |
| Sur | 25545158 | 25540246 |
| Al Kamil | 25557524 | 25558254 |
| Bani Bu Ali | 25554015 | 25554138 |
| Jalaan | 25550020 | 25550110 |
| Masirah | 25504516 | 25504026 |
| Al Mudhaibi | 25578484 | 25578014 |
| Sinaw | 25524212 | 25524223 |
| Duqum | 25427101 | 25427130 |

| Dhofar Region Branches | | |
|---|---|---|
| Branch | Telephone No | |
| Salalah | 23291346 | 23291601 |
| SQH | 23211092 | 23211042 |
| Mirbat | 23268345 | 23268346 |
| Saada | 23225283 | 23226031 |
| New Salalah | 23298037 | 23298037 |

| Sadara Centre | | |
|---|---|---|
| Branch | Telephone No | |
| Azaiba New HO | 24778134 | |
| CBD | 24778002 | |
| Mina Al Fahal | 24565163 | |
| Al Khuwair | 24487356 | |
| Shatti Al Qurum | 24607012 | |
| MOE | 24510007 | |
| Al Mawaleh Centre | 24348118 | |
| Al Khoud Centre | 24271367 | |
| Barka Centre | 26882007 | |
| Saham Centre | 26855146 | |
| Sohar Industrial Area | 26755889 | |
| Nizwa Firq Center | 25431122 | |
| Sur Centre | 25545414 | |
| Sohar Hambar Centre | 26859103 | |
| Salalah Centre | 23291346 | |
| Rustaq centre | 26878334 | |
| Buraimi | 25691161 | |

| Muzn Islamic banking | | |
|---|---|---|
| Branch | Telephone No | |
| Azaiba | 24617013 | 24617014 |
| Sur | 25540642 | |
| Sohar | 26846992 | |
| Nizwa | 25411241 | 25411681 |
| Salalah | 23289230 | 23291310 |
| Maabella | 24452304 | 24458304 |

| UAE Branches | |
|---|---|
| Branch | Telephone No |
| Abu Dhabi | 97126974000 |
| Dubai | 97143049400 |

**National Bank of Oman**
PO Box 751
Ruwi, Muscat
Sultanate of Oman
**nbo.om**