

Commercial Bank of Dubai PSC

Consolidated financial statements

31 December 2019

Commercial Bank of Dubai PSC

Consolidated financial statements

For the year ended 31 December 2019

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Independent Auditors' Report

To the Shareholders of Commercial Bank of Dubai PSC

Report on the audit of the consolidated financial statements

Opinion

We have audited the consolidated financial statements of Commercial Bank of Dubai PSC (the "Bank") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2019, the consolidated statements of profit or loss, profit or loss and other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for opinion

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

Key audit matters

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



Key audit matters (continued)

Impairment of loans and advances and Islamic Financing

Refer to notes 9 and 35 (b) of the consolidated financial statements for year-end disclosures.

The Group recognized allowances for credit losses on its consolidated statement of financial position using an expected credit loss model ("ECL"). The Group exercises significant judgments and makes a number of assumptions in developing its ECL models, which include probability of default, loss given default, exposure at default, forward looking information and staging criteria. Qualitative adjustments or overlays may also be recorded by the Group using credit judgement where the inputs, assumptions and / or modelling techniques do not capture all relevant risk factors.

Given the inherently judgemental nature of computation of ECL for loans and advances and Islamic financing, this is considered a key audit matter.

Our response

We have performed end to end process walkthroughs to identify the key systems, applications and controls used in the ECL process and to understand the governance framework around model review, validation and approval of ECL model, data gathering, and its integrity and underlying estimates and assumptions used by management.

Our procedures included the following:

- Testing key controls over the modelling process, including model review, validation and approval;
- Testing key controls over the accuracy of key inputs used in the models;
- Testing key controls over Significant Increase in Credit Risk ("SICR") criteria, which involved testing controls relating to authorisation of the criteria and the application of the criteria in the models;
- Testing key controls over internal credit grading (which is a key driver in determining SICR) and monitoring process, to assess if the risk grades allocated to counterparties were appropriately identified and updated on a timely basis;
- Testing the design and implementation over the assessment of model outputs and authorisation and review of post model adjustments and management overlays;



Key audit matters (continued)

Impairment of loans and advances and Islamic Financing (continued)

- We involved our Financial Risk Modelling ("FRM") specialists to review the reasonableness and appropriateness of the methodology and assumptions used in various components of ECL modelling. This included challenging key assumptions/judgments relating to significant increase in credit risk, definition of default, probability of default, recovery rates, use of macro-economic variables and probability weighted outcomes. FRM specialists also re-performed key elements of the Group's models calculations and evaluated the models performance results for accuracy;
- We have involved our Information Technology ("IT") specialists to assist in testing the relevant General IT and Application Controls over Key Systems used in the ECL process;
- Sample testing over key inputs impacting ECL calculations to confirm the accuracy of information used and evaluating key assumptions including economic forecasts and weightages;
- Re-performing key aspects of the Group's SICR determinations and selecting samples of loans and advances to determine whether a SICR was appropriately identified;
- Selecting a sample of post model adjustments and management overlays in order to assess the reasonableness of the adjustments by challenging key assumptions, inspecting the calculation methodology and tracing to source data on a sample basis;
- Performing credit assessments for a sample of selected customers, including Stage 3 customers, to test the appropriateness of the credit grades at a given point in time and assess the financial performance of the borrower, source of repayment and future cash flows of the borrower to assess recoverability and ECL by comparing key assumptions to progress against business plans and our own understanding of relevant industries and business environment and where possible to externally derived evidence such as business performance and real estate valuations for assessing the appropriateness of collateral values held by the Group; and
- Assessing the adequacy of the Group's disclosure in relation to the requirements of IFRS 7 and IFRS 9.



Other information

Management is responsible for the other information. The other information comprises the Directors' report which we obtained prior to the date of this auditors' report, and the Chairman's message, List of Board of Directors, Corporate Governance Framework Report, List of Executive Committee and Major Indicators ("the Reports") which are expected to be made available to us after that date.

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

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

When we read the Reports, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and take appropriate actions in accordance with ISAs.

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

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

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

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

Auditors' responsibilities for the audit of the consolidated financial statements

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



*Auditors' responsibilities for the audit of the consolidated financial statements
(continued)*

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

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

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



*Auditors' responsibilities for the audit of the consolidated financial statements
(continued)*

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

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

Report on other legal and regulatory requirements

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

- i) we have obtained all the information we considered necessary for the purposes of our audit;
- ii) the consolidated financial statements have been prepared and comply, in all material respects, with the applicable provisions of the UAE Federal Law No. (2) of 2015;
- iii) the Group has maintained proper books of account;
- iv) the financial information included in the Directors' report, in so far as it relates to these consolidated financial statements, is consistent with the books of account of the Group;
- v) as disclosed in note 10 to the consolidated financial statements, the Group has purchased or invested in shares during the financial year ended 31 December 2019;
- vi) note 33 to the consolidated financial statements discloses material related party transactions and the terms under which they were conducted;
- vii) based on the information that has been made available to us, nothing has come to our attention which causes us to believe that the Group has contravened during the financial year ended 31 December 2019 any of the applicable provisions of the UAE Federal Law No.(2) of 2015 or in respect of the Group, its Articles of Association, which would materially affect its activities or its consolidated financial position as at 31 December 2019; and
- viii) note 25 to the consolidated financial statements discloses the social contributions made during the year.



Report on other legal and regulatory requirements (continued)

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

KPMG Lower Gulf Limited

Emilio Pera

Registration number: 1146

Dubai, United Arab Emirates

Date: 23 Feb 2020

Commercial Bank of Dubai PSC

Consolidated statement of financial position

As at 31 December 2019

	Note	2019 AED'000	2018 AED'000
ASSETS			
Cash and balances with Central Bank	7	12,592,641	8,682,322
Due from banks, net	8	2,427,735	971,280
Loans and advances and Islamic financing, net	9	60,180,810	50,944,947
Investment securities	10	5,613,287	6,751,150
Investment in an associate	11	85,127	84,842
Investment properties, net	12	198,896	214,420
Property and equipment	13	273,583	343,093
Bankers acceptances		5,346,819	5,266,428
Other assets, net	14	1,349,993	843,064
TOTAL ASSETS		88,068,891	74,101,546
LIABILITIES AND EQUITY			
LIABILITIES			
Due to banks	15	4,166,589	2,762,944
Customer deposits and Islamic customer deposits	16	63,334,333	53,165,030
Notes and medium term borrowings	17	3,231,072	2,609,944
Due for trade acceptances		5,346,819	5,266,428
Other liabilities	18	1,773,508	1,078,474
TOTAL LIABILITIES		77,852,321	64,882,820
EQUITY			
Share capital	19.1	2,802,734	2,802,734
Legal and statutory reserve	19.2	1,401,367	1,401,367
General reserve	19.3	1,328,025	1,328,025
Capital reserve	19.4	38,638	38,638
Fair value reserve	19.5	48,454	(137,060)
Retained earnings		4,597,352	3,785,022
TOTAL EQUITY		10,216,570	9,218,726
TOTAL LIABILITIES AND EQUITY		88,068,891	74,101,546

These consolidated financial statements were approved and authorised for issue by the Board of Directors on 05 February 2020.

The attached notes from 1 to 37 form part of these consolidated financial statements.

The report of the Auditors' is set out on pages 2 to 8.



H.E. Humaid Al Qutami
Chairman



Dr. Bernd van Linder
Chief Executive Officer

Commercial Bank of Dubai PSC

Consolidated statement of profit or loss

For the year ended 31 December 2019

	Note	2019 AED'000	2018 AED'000
Interest income and income from Islamic financing	20	3,177,489	2,847,213
Interest expense and distributions to Islamic depositors	21	(1,211,907)	(935,990)
Net interest income and net income from Islamic financing		1,965,582	1,911,223
Net fees and commission income	22	701,154	578,205
Net gains from foreign exchange and derivatives		196,817	142,969
Net gains from investments at fair value through profit or loss	23	1,412	650
Net gains from sale of debt investments at fair value through other comprehensive income		53,127	6,914
Share of profit of an associate	11	4,318	9,621
Dividend income		3,488	5,126
Other income	24	107,316	69,995
Total operating income		3,033,214	2,724,703
Reversal / (impairment allowance) on due from banks		2	(2,951)
Impairment allowance on loans and advances and Islamic financing		(782,312)	(727,410)
Recoveries		41,516	47,770
Reversal of impairment allowance on investment securities		162	1,056
Impairment allowance on investment property	12	(3,322)	-
Impairment allowance on other assets		(3,900)	(22,730)
Total net income		2,285,360	2,020,438
Staff and other expenses	25	(814,771)	(795,354)
Depreciation and amortisation	12 & 13	(70,399)	(62,973)
Total operating expenses		(885,170)	(858,327)
Net profit for the year		1,400,190	1,162,111
Basic and diluted earnings per share	27	AED 0.50	AED 0.41

The attached notes from 1 to 37 form part of these consolidated financial statements.

The report of the Auditors' is set out on pages 2 to 8.

Commercial Bank of Dubai PSC

Consolidated statement of profit or loss and other comprehensive income

For the year ended 31 December 2019

	2019 AED'000	2018 AED'000
Net profit for the year	1,400,190	1,162,111
Items that will not be reclassified to profit or loss:		
Realised gain on sale of equity investments held at fair value through other comprehensive income	3,730	1,384
Revaluation loss of equity investments held at fair value through other comprehensive income	(12,561)	(12,391)
Actuarial gain / (loss) on retirement benefits obligations	2,985	(1,061)
Items that may be subsequently reclassified to profit or loss:		
Changes in fair value of effective portion of cash flow hedge	4,453	4,881
Changes in fair value reserve of an associate	383	(147)
Changes in investments held at fair value through other comprehensive income:		
Realised gain on sale of debt investments	(53,127)	(6,914)
Revaluation gain / (loss) on debt investments	243,381	(110,472)
Net change in investments held at fair value through other comprehensive income	190,254	(117,386)
Other comprehensive income / (loss) for the year	189,244	(124,720)
Total comprehensive income for the year	1,589,434	1,037,391

The attached notes from 1 to 37 form part of these consolidated financial statements.

The report of the Auditors' is set out on pages 2 to 8.

Commercial Bank of Dubai PSC

Consolidated statement of changes in equity

For the year ended 31 December 2019

	Share capital AED'000	Legal and statutory reserve AED'000	General reserve AED'000	Capital reserve AED'000	Fair value reserve AED'000	Retained earnings AED'000	Total AED'000
At 1 January 2018	2,802,734	1,401,367	1,328,025	38,638	(10,956)	3,520,947	9,080,755
IFRS 9 adjustment	-	-	-	-	-	(397,495)	(397,495)
	2,802,734	1,401,367	1,328,025	38,638	(10,956)	3,123,452	8,683,260
Transactions with shareholders, recorded directly in equity							
Cash dividend for 2017 (17.5%)	-	-	-	-	-	(490,478)	(490,478)
Directors' remuneration for 2017	-	-	-	-	-	(11,000)	(11,000)
Share of Directors' remuneration of an associate (note 11)	-	-	-	-	-	(447)	(447)
Other comprehensive income							
Net profit for the year	-	-	-	-	-	1,162,111	1,162,111
Gain on sale of equity investments at fair value through other comprehensive income	-	-	-	-	(1,384)	1,384	-
Other comprehensive loss for the year	-	-	-	-	(124,720)	-	(124,720)
Total other comprehensive income	-	-	-	-	(126,104)	1,163,495	1,037,391
At 31 December 2018	2,802,734	1,401,367	1,328,025	38,638	(137,060)	3,785,022	9,218,726
Transactions with shareholders, recorded directly in equity							
Cash dividend for 2018 (20.7%)	-	-	-	-	-	(580,166)	(580,166)
Directors' remuneration for 2018	-	-	-	-	-	(11,000)	(11,000)
Share of Directors' remuneration of an associate (note 11)	-	-	-	-	-	(424)	(424)
Other comprehensive income							
Net profit for the year	-	-	-	-	-	1,400,190	1,400,190
Gain on sale of equity investments at fair value through other comprehensive income	-	-	-	-	(3,730)	3,730	-
Other comprehensive income for the year	-	-	-	-	189,244	-	189,244
Total other comprehensive income	-	-	-	-	185,514	1,403,920	1,589,434
At 31 December 2019	2,802,734	1,401,367	1,328,025	38,638	48,454	4,597,352	10,216,570

The attached notes from 1 to 37 form part of these consolidated financial statements.

The report of the Auditors' is set out on pages 2 to 8.

Commercial Bank of Dubai PSC

Consolidated statement of cash flows

For the year ended 31 December 2019

	Note	2019 AED'000	2018 AED'000
OPERATING ACTIVITIES			
Net profit for the year		1,400,190	1,162,111
Adjustments for:			
Depreciation and amortisation	12 & 13	70,399	62,973
Amortisation of premium / discounts on investments		35,328	49,331
Amortisation of transaction cost on notes and medium term borrowings		1,537	9,631
Loss on forex translation on investments		5,998	7,706
Realised gain on sale of investments		(53,976)	(7,175)
Net unrealised gain on derivatives		(53,399)	(30,556)
Reversal of impairment allowance on investment securities		(162)	(1,056)
Share of profit of an associate	11	(4,318)	(9,621)
Dividend income		(3,488)	(5,126)
Impairment allowance on loans and advances and Islamic financing		782,312	727,410
(Reversal) / impairment allowance on due from banks		(2)	2,951
Impairment allowance on other assets		3,900	22,730
Impairment allowance on investment properties	12	3,322	-
(gain) / loss on disposal of property and equipment		(73,636)	81
		<u>2,114,005</u>	<u>1,991,390</u>
Increase in statutory reserve with the Central Bank		(513,532)	(177,398)
(Increase) / decrease in negotiable Central Bank certificate of deposits with original maturity of more than three months		(700,000)	700,000
Increase in due from banks with original maturity of more than three months		(50,431)	(157,528)
Increase in loans and advances and Islamic financing		(10,018,175)	(4,785,380)
Increase in other assets		(130,356)	(193,833)
Increase in due to banks with original maturity of more than three months		1,325,867	1,447,912
Increase in customer deposits and Islamic customer deposits		10,169,303	4,753,838
Increase in other liabilities		373,331	143,672
Directors' remuneration paid		(11,000)	(11,000)
Net cash flow from operating activities		<u>2,559,012</u>	<u>3,711,673</u>
INVESTING ACTIVITIES			
Purchase of investments		(4,224,500)	(2,950,319)
Proceeds from sale of investments		5,558,665	3,094,592
Purchase of property and equipment	13	(27,291)	(43,822)
Proceeds from sale of property and equipment		112,240	1,939
Dividend received		3,488	5,126
Dividend from an associate	11	3,992	3,992
Net cash flow from investing activities		<u>1,426,594</u>	<u>111,508</u>
FINANCING ACTIVITIES			
Notes and medium term borrowings		619,591	(3,489,350)
Dividend paid		(580,166)	(490,478)
Net cash flow from / (used in) financing activities		<u>39,425</u>	<u>(3,979,828)</u>
Net increase / (decrease) in cash and cash equivalents		<u>4,025,031</u>	<u>(156,647)</u>
Cash and cash equivalents at 1 January		<u>3,315,334</u>	<u>3,471,981</u>
Cash and cash equivalents at 31 December	28	<u>7,340,365</u>	<u>3,315,334</u>
<u>Supplemental disclosure:</u>			
Interest income and income from Islamic financing received		3,155,272	2,781,643
Interest expense and distributions to Islamic depositors paid		1,131,154	812,883

The attached notes from 1 to 37 form part of these consolidated financial statements.

The report of the Auditors' is set out on pages 2 to 8.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

1 LEGAL STATUS AND ACTIVITIES

Commercial Bank of Dubai PSC (“the Bank”) was incorporated in Dubai, United Arab Emirates (U.A.E.) in 1969 and is registered as a Public Shareholding Company (PSC) in accordance with Federal Law No. 2 of 2015. The Bank is listed on the Dubai Financial Market. The Bank’s principal activity is commercial banking. The registered address of the Bank is Al Ittihad Street, P.O. Box 2668, Dubai, United Arab Emirates.

The consolidated financial statements of the Group for the year ended 31 December 2019 comprise the results of the Bank, its wholly owned subsidiaries (together referred to as “the Group”) and the Group’s interest in an associate.

Details about subsidiaries and an associate:

- a) CBD Financial Services LLC, is registered as a limited liability company in accordance with Federal Law No. 2 of 2015 in Dubai, United Arab Emirates. The Bank holds a 100% interest. Its principal activity is providing brokerage facilities for local shares and bonds.
- b) CBD Employment Services One Person Company LLC, is registered as a limited liability company in accordance with Federal Law No. 2 of 2015 in Dubai, United Arab Emirates. The Bank holds 100% interest. Its principal activity is supply of manpower services.
- c) Attijari Properties LLC, is registered as a limited liability company in accordance with Federal Law No. 2 of 2015 in Dubai, United Arab Emirates. The Bank holds a 100% interest. Its principal activity is self-owned property management services as well as buying and selling of real estate.
- d) CBD (Cayman) Limited is a special purpose entity (SPE) registered in the Cayman Islands. The SPE has been established for issuance of debt securities.
- e) CBD (Cayman II) Limited, which is a special purpose entity (SPE) registered in the Cayman Islands. The SPE has been established to transact and negotiate derivative agreements.
- f) VS 1897 (Cayman) Limited which is a special purpose entity (SPE) registered in the Cayman Islands. The SPE has been established to manage investment acquired in settlement of debt.
- g) National General Insurance Co. (PSC) is an associate of the Bank and is listed on the Dubai Financial Market. It underwrites all classes of life and general insurance business as well as certain reinsurance business. The Bank holds 17.8% interest in the associate. The management believes that it has significant influence on the associate by virtue of having representation on the Board of Directors of the associate.

2 BASIS OF PREPARATION

2.1 Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and comply with relevant laws of the U.A.E.

As required by the UAE Securities and Commodities Authority (SCA) notification number 85/2009 dated January 6, 2009, the Group’s exposure in cash and advances with Central Bank of the UAE, Due from Banks and Investment Securities outside the UAE have been presented under the respective notes.

2.2 Functional and presentation currency

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

2.3 Use of estimates and judgments

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgment or complexity are disclosed in note 4.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

2 BASIS OF PREPARATION (CONTINUED)

2.4 Basis of measurement

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

- derivative financial instruments are measured at fair value;
- financial instruments classified as trading and fair value through profit or loss (FVPL);
- financial assets at fair value through other comprehensive income;
- recognised financial assets and financial liabilities that are hedged items in a fair value hedge transaction are measured at fair value in respect of the risk that is hedged. Amortised cost is adjusted for hedging gain or loss;
- end of service benefits that are measured at the present value of the defined benefit obligation.

2.5 Basis of consolidation

The consolidated financial statements comprise the financial statements of the Bank and its subsidiaries. Subsidiaries are entities controlled by the Group.

(i) Business Combination

The Group accounts for business combinations using the acquisition method when control is transferred to the Group. The consideration transferred in the acquisition is generally measured at fair value, as are the identifiable net assets acquired.

(ii) Subsidiary

The Group controls an investee if and only if the Group has:

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

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

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

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary.

Profit or loss and each component of other comprehensive income (OCI) are attributed to the equity holders of the parent of the Group and to the non-controlling interest (NCI). When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with the Group's accounting policies.

A change in the ownership interest of a subsidiary, without a loss of control, is accounted for as an equity transaction. If the Group loses control over a subsidiary, it:

- Derecognises the assets (including goodwill) and liabilities of the subsidiary;
- Derecognises the cumulative translation differences recorded in equity;
- Derecognises the carrying amount of any non-controlling interest;
- Recognises the fair value of the consideration received;
- Recognises the fair value of any investment retained;
- Recognises any surplus or deficit in the consolidated statement of profit or loss; and
- Reclassifies the parent's share of components previously recognised in consolidated OCI to consolidated statement of profit or loss or retained earnings, as appropriate, as would be required if the Group had directly disposed of the related assets or liabilities.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

2 BASIS OF PREPARATION (CONTINUED)

2.5 Basis of consolidation (continued)

When the Group loses control of a subsidiary, a gain or loss is recognised in the consolidated statement of profit or loss and is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest, and (ii) the previous carrying amount of the assets (including goodwill) and liabilities of the subsidiary, and any non-controlling interests.

All amounts previously recognised in other comprehensive income in relation to that subsidiary are accounted for as if the Group had directly disposed of the related assets or liabilities of the subsidiary (i.e. reclassified to profit or loss or transferred to another category of equity).

The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IFRS 9, when applicable, the cost on initial recognition of an investment in an associate or a joint venture.

(iii) Associate

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

The Group's investment in its associate is accounted for using the equity method.

Under the equity method, the investment in an associate is initially recognised at cost. The carrying amount of the investment is adjusted to recognise changes in the Group's share of net assets of the associate since the acquisition date. Goodwill relating to the associate is included in the carrying amount of the investment and is neither amortised nor individually tested for impairment.

The consolidated statement of profit or loss reflects the Group's share of the results of operations of the associate. Any change in OCI of those investees is presented as part of the Group's OCI. In addition, when there has been a change recognised directly in the equity of the associate, the Group recognises its share of any changes, when applicable, in the consolidated statement of changes in equity. The aggregate of the Group's share of profit or loss of an associate is shown on the face of the consolidated statement of profit or loss.

The financial statements of the associate are prepared for the same reporting period as the Group. When necessary, adjustments are made to bring the accounting policies in line with those of the Group.

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

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

Management reviews its share of investments in associates to assess impairment on a regular basis. In determining the assessment, management compares the recoverable amount with the carrying value of the investment. Estimating recoverable amount using value in use requires the Group to make an estimate of the expected future cash flows from the associates and choosing a suitable discount rate in order to calculate the present value of those cash flows.

(iv) Transactions eliminated on consolidation

Intra-group balances and income and expenses (except for foreign currency translation gains or losses) arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

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3 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all the years presented in these consolidated financial statements, except for the adoption of IFRS 16 Leases for the first time as described below, and accounting standards as mentioned in note 5.1.

Transition

The Group has adopted IFRS 16 retrospectively from 1 January 2019, but has not restated comparatives for the 2018 reporting period, as permitted under specific transitional provisions in the standard. The reclassifications and adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on 1 January 2019.

Adjustments recognised on adoption of IFRS 16

On adoption of IFRS 16, the group recognised lease liabilities in relation to leases which had previously been classified as 'Operating leases' under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of 1 January 2019. The Financial Impact of adopting the standard is not material.

There were no leases previously classified as finance lease by the entity.

Group's leasing activities and how they are accounted for

During the financial year 2018, leases of office premises were classified as operating lease. Payments made under the operating leases (net of any incentives received from the lessor) were charged to profit and loss account on a straight line basis over the period of lease.

From 1 January 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- Amounts expected to be payable by the lessee under residual value guarantees;
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

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

Right-of-use assets are measured at cost comprising the following:

- Any lease payments made at or before the commencement date less any lease incentives received
- Any initial direct costs, and
- Restoration costs.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) **Group's leasing activities and how they are accounted for (continued)**

Critical judgments in determining the lease term:

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). The assessment is reviewed if a significant event or a significant change in circumstances occurs which affects this assessment and that is within the control of the lessee.

Payments associated with short-term leases and leases of low-value assets are recognised on a straight-line basis as an expense in profit or loss. Short-term leases are leases with a lease term of 12 months or less.

Residual value guarantees:

The group initially estimates and recognises amounts expected to be payable under residual value guarantees as part of the lease liability. The amounts are reviewed, and adjusted if appropriate, at the end of each reporting period.

3.1 Financial Instruments

a) Recognition and initial measurement

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

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

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

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

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

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

b) Fair Value measurement

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

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

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

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.

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1 Financial Instruments (continued)

b) Fair Value measurement (continued)

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

Fair value hierarchy

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

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

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

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

The hierarchy used by the Group is set out in note 6.2.

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

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

For the purpose of fair value disclosures, the Group 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.

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets

a) Classification

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

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

o **Business model assessment**

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

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

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

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

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

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

This includes assessing whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making the assessment, the Group considers:

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

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

a) Classification (continued)

o *Assessment whether contractual cash flows is solely payments of principal and interest (continued)*

The Group holds a portfolio of long-term fixed-rate loans for which the Group 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 Group has determined that the contractual cash flows of these loans are SPPI 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.

Non-recourse loans

In some cases, loans made by the Group that are secured by collateral of the borrower limit the Group's claim to cash flows of the underlying collateral (non-recourse loans). The Group applies judgment in assessing whether the non-recourse loans meet the SPPI criterion. The Group typically considers the following information when making this judgement:

- whether the contractual arrangement specifically defines the amounts and dates of the cash payments of the loan;
- the fair value of the collateral relative to the amount of the secured financial asset;
- the ability and willingness of the borrower to make contractual payments, notwithstanding a decline in the value of collateral;
- whether the borrower is an individual or a substantive operating entity or is a special-purpose entity;
- the Group's risk of loss on the asset relative to a full-recourse loan;
- the extent to which the collateral represents all or a substantial portion of the borrower's assets; and
- whether the Group will benefit from any upside from the underlying assets.

(i) *Financial assets at amortized cost*

A debt instrument, including loans and advances and Islamic financing asset is classified as being measured at amortized cost if it meets both of the following conditions and is not designated as at FVPL:

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

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

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

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

The Group measures all equity investments at fair value through profit or loss, except where the Group's management has elected, at initial recognition, to irrevocably designate an equity investment at fair value through other comprehensive income. The Group's policy is to designate equity investments as FVOCI when those investments are held for purposes other than to generate investment returns. This election is made on an investment-by-investment basis.

(iii) *Financial assets at fair value through profit or loss (FVPL)*

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVPL.

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

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

b) Subsequent measurement

The Group measures financial instruments, such as derivatives and investments in equity and certain fixed income instruments, at fair value at each reporting date.

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

c) Reclassifications

Financial assets are not reclassified subsequent to their initial recognition except in the period after the Group changes its business model for managing financial assets. If the business model under which the Group holds financial assets changes, the financial assets affected are reclassified. The classification and measurement requirements related to the new category apply prospectively from the first day of the first reporting period following the change in business model that results in reclassifying the Group's financial assets. During the current and previous financial year there was no change in the business model under which the Group holds financial assets and therefore no reclassifications were made. Changes in contractual cash flows are considered under the accounting policy on '*Modification of financial assets*' and '*Derecognition of financial assets*' described in note 3.1.1 (g) and 3.1.1 (h) respectively).

d) Foreign exchange gains and losses

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

- for financial assets measured at amortised cost that are not part of a designated hedging relationship, exchange differences are recognised in consolidated statement of profit or loss in the 'net gains from foreign exchange and derivatives' line item;
- for debt instruments measured at FVOCI that are not part of a designated hedging relationship, exchange differences on the amortised cost of the debt instrument are recognised in the consolidated statement of profit or loss in the 'net gains from foreign exchange and derivatives' line item. Other exchange differences are recognised in OCI in the investments revaluation reserve;
- for financial assets measured at FVPL that are not part of a designated hedge accounting relationship, exchange differences are recognised in consolidated statement of profit or loss in 'net gains from investments at FVPL'; and
- for equity instruments measured at FVOCI, exchange differences are recognised in OCI in the investments revaluation reserve.

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment

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

- balances with central banks;
- due from banks;
- debt investment securities;
- loans and advances, Islamic financing and other financial assets;
- loan commitments; and
- financial guarantee contracts.

No impairment loss is recognised on equity investments.

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

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

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

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

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

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

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

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

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

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

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

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

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3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment (continued)

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

Details of these statistical parameters / inputs are as follows:

- PD – PD is the estimate of likelihood of default over a given time horizon, which is calculated based on statistical rating models currently used by the Group, and assessed using rating tools tailored to the various categories of counterparties and exposures.
- EAD – EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amount allowed under the contract and arising from amortisation. The EAD of a financial asset is its gross carrying amount at the time of default. For lending commitments, the EADs are potential future amounts that may be drawn under the contract, which are estimated based on historical observations and forward-looking forecasts. For financial guarantees, the EAD represents the amount of the guaranteed exposure when the financial guarantee becomes payable. For some financial assets, EAD is determined by modelling the range of possible exposure outcomes at various points in time using scenario and statistical techniques.
- LGD – LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the lender would expect to receive, taking into account cash flows from any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross-collateralisation and seniority of claim, cost of realisation of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, history of recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original EIR of the loan.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics that include:

- instrument type;
- credit risk grading;
- collateral type;
- Loan to value ratio for retail exposure;
- date of initial recognition;
- remaining term of maturity;
- industry; and
- geography location of the borrower.

The groupings are subject to regular review to ensure that exposure within a particular group remain appropriately homogenous.

Restructured financial assets

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

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

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Notes to the consolidated financial statements

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3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Credit-impaired financial assets

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

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

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

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

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

A loan is considered credit-impaired when a concession is granted to the borrower due to a deterioration in the borrower's financial condition, unless there is evidence that as a result of granting the concession the risk of not receiving the contractual cash flows has reduced significantly and there are no other indicators of impairment.

For financial assets where concessions are contemplated but not granted, the asset is deemed credit impaired when there is observable evidence of credit-impairment including meeting the definition of default. The definition of default includes unlikelihood to pay indicators and a backstop if amounts are overdue for 90 days or more.

Purchased or originated credit-impaired (POCI) financial assets

For POCI financial assets, the Group recognises all changes in LTECL since initial recognition as a loss allowance with any changes recognised in consolidated statement of profit or loss. A favourable change for such assets creates an impairment gain.

Default definition

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

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

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

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For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Default definition (continued)

Overdrafts are considered as being past due once the customer has breached an advised limit or been advised of a limit smaller than the current amount outstanding.

- it is becoming probable that the borrower will restructure the asset as a result of bankruptcy due to the borrower's inability to pay its credit obligations.

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

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

The Group has performed a historical default rate analysis to identify homogeneous segments and further estimated ECL parameters (i.e. PD, LGD and EAD) at similar granularities. To perform a historical default rate analysis, the Group has adopted two separate definitions of default for the non-retail and the retail portfolio.

o *Non-retail portfolio*

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

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

o *Retail portfolio*

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

Assessment of significant increase in credit risk

The Group's accounting policy is not to use the practical expedient that financial assets with 'low' credit risk at the reporting date are deemed not to have had a significant increase in credit risk. As a result, the Group monitors all financial assets, issued loan commitments and financial guarantee contracts that are subject to the impairment requirements to assess whether there has been a significant increase in credit risk since initial recognition. If there has been a significant increase in credit risk, the Group will measure the loss allowance based on lifetime rather than 12-month ECL. The assessment is performed on at least quarterly basis for each individual exposure.

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

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Assessment of significant increase in credit risk (continued)

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

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

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

As a back stop, a significant increase in credit risk is presumed if a customer is more than 30 days past due in making a contractual payment. Days past due are determined by counting the number of days since the earliest elapsed due date in respect of which full payment has not been received. Due dates are determined without considering any grace period that might be available to the borrower.

For retail lending the Group considers credit scores and events such as unemployment, bankruptcy or death. As a back-stop when an asset becomes 30 days past due, the Group considers that a significant increase in credit risk has occurred and the asset is in Stage 2 of the impairment model, i.e. the loss allowance is measured as the lifetime ECL.

Improvement in credit risk profile

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

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

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

Incorporation of forward-looking information

The Group incorporates forward-looking information into both its assessment of whether the credit risk of an instrument has increased significantly since its initial recognition and its measurement of ECL. The Group relies on a broad range of forward looking information as economic inputs such as:

- GDP growth rates;
- UAE Central Bank base rate;
- House prices; and
- Unemployment rates; etc.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

e) Impairment (continued)

Incorporation of forward-looking information (continued)

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

The Group formulates three economic scenarios: a base case, which is the median scenario assigned a 80% probability of occurring, and two less likely scenarios, one upside and one downside, each assigned a 10% probability of occurring.

Presentation of allowance for ECL in the statement of financial position

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

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

f) Write-off

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

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

g) Modification of financial assets

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

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

g) Modification of financial assets (continued)

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

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

If cash flows are modified when the borrower is in financial difficulties, then the objective of the modification is usually to maximise recovery of the original contractual terms rather than to originate a new asset with substantially different terms. The revised terms usually include extending the maturity, changing the timing of interest payments and amending the terms of loan covenants. Both retail and corporate loans are subject to the forbearance policy. The Group Credit Committee regularly reviews reports on forbearance activities.

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

Generally, forbearance is a qualitative indicator of a significant increase in credit risk and an expectation of forbearance may constitute evidence that an exposure is credit-impaired. For financial assets modified as part of the Group's forbearance policy, where modification did not result in derecognition, the estimate of PD reflects the Group's ability to collect the modified cash flows taking into account the Group's previous experience of similar forbearance action, as well as various behavioural indicators, including the borrower's payment performance against the modified contractual terms.

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

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.1 Financial assets (continued)

h) Derecognition of financial assets

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

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

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

Any cumulative gain / loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in the consolidated statement of profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

3.1.2 Financial liabilities

a) Classification

The Group classifies its financial liabilities in the following categories:

- (i) Fair value through profit or loss; and
- (ii) Amortised cost.

(i) Financial liabilities at FVPL

Financial liabilities are classified as at FVPL when the financial liability is (i) held for trading, or (ii) it is designated as at FVPL. A financial liability is classified as held for trading if:

- it has been incurred principally for the purpose of repurchasing it in the near term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and is effective as a hedging instrument.

A financial liability other than a financial liability held for trading or contingent consideration that may be paid by an acquirer as part of a business combination may be designated as at FVPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IFRS 9 permits the entire hybrid (combined) contract to be designated as at FVPL.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.2 Financial liabilities (continued)

(i) Financial liabilities at FVPL (continued)

Subsequent measurement

Financial liabilities at FVPL are stated at fair value, with any gains / losses arising on remeasurement recognised in profit or loss to the extent that they are not part of a designated hedging relationship. The net gain / loss recognised in consolidated statement of profit or loss incorporates any interest paid on the financial liability.

However, for non-derivative financial liabilities that are designated as at FVPL, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in OCI, unless the recognition of the effects of changes in the liability's credit risk in OCI would create or enlarge an accounting mismatch in profit or loss. The remaining amount of change in the fair value of liability is recognised in profit or loss. Changes in fair value attributable to a financial liability's credit risk that are recognised in OCI are not subsequently reclassified to consolidated statement of profit or loss; instead, they are transferred to retained earnings upon derecognition of the financial liability.

In making the determination of whether recognising changes in the liability's credit risk in OCI will create or enlarge an accounting mismatch in profit or loss, the Group assesses whether it expects that the effects of changes in the liability's credit risk will be offset in profit or loss by a change in the fair value of another financial instrument measured at FVPL. This determination is made at initial recognition.

Fair value is determined in the manner described in note 3.1 (b).

(ii) Financial liabilities at amortised cost

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

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

b) Modification of financial liabilities

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

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

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.1.2 Financial liabilities (continued)

c) Derecognition of financial liabilities

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

When the Group exchanges with the existing lender one debt instrument into another one with substantially different terms, such exchange is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

3.1.3 Financial guarantee contracts

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

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

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

3.1.4 Loan commitments

Loan commitments are firm commitments to provide credit under pre-specified terms and conditions. Commitments to provide a loan at a below-market interest rate are initially measured at their fair values and, if not designated as at FVPL, are subsequently measured as follows:

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

The Group has not designated any commitments to provide a loan below market rate designated at FVPL.

3.2 Derivative financial instruments

a) Classification

The Group enters into derivative financial instruments including forwards, futures, swaps and options in the foreign exchange and capital markets. Derivative financial instruments, that do not qualify for hedge accounting are classified as "FVPL – financial assets held for trading" financial instruments.

b) Initial and subsequent measurement

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.2 Derivative financial instruments (continued)

c) Gains and losses on subsequent measurement

The gains or losses from derivative financial instruments classified as FVPL are taken to the consolidated statement of profit or loss.

3.3 Hedging instruments

As part of its asset and liability management, the Group uses derivatives for hedging purpose.

When derivatives are designated as hedges, the Group classifies them as either:

- fair value hedges which hedge the change in the fair value of recognised assets or liabilities; or
- cash flow hedges which hedge the exposure to variability in highly probable future cash flows attributable to a recognised asset or liability or a forecast transaction.

Hedge accounting is applied to derivatives designated as hedging instruments in fair value or cash flow hedge provided certain criteria are met.

Hedge accounting

a) Hedge documentation

At the inception of the hedge, formal documentation of the hedge relationship must be established. The hedge documentation prepared at the inception of the hedge must include a description of the following:

- The Group's risk management objective and strategy for undertaking the hedge;
- The nature of risk being hedged;
- Clear identification of the hedged item and the hedging instrument; and
- How the Group will assess the effectiveness of the hedging relationship on an ongoing basis.

b) Hedge effectiveness testing

The hedge is regarded as highly effective if both of the following conditions are met:

- At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in offsetting the changes in fair value or cash flows of the hedging instruments with corresponding changes in the hedged risk and should be reliably measurable; and
- The actual results of the hedge effectiveness testing are within a range of 80 to 125 percent.

In case of a cash flow hedge, prospective hedge effectiveness is assessed by matching the critical terms of hedging instruments and hedged items.

c) Fair value hedge

The changes in the fair value of derivatives that are designated and qualify as fair value hedge instruments is recognised in the consolidated statement of profit or loss.

d) Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in OCI. Any gain or loss in fair value relating to an ineffective portion is recognised immediately in the consolidated statement of profit or loss.

e) Discontinuance of hedge accounting

The hedge accounting is discontinued when a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting. At that point of time, any cumulative gain or loss on the hedging instrument that has been recognised in OCI remains in other comprehensive income until the forecast transaction occurs. 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 consolidated statement of profit or loss.

f) Hedges that do not qualify for hedge accounting

For hedges that do not qualify for hedge accounting, any gains or losses arising from changes in the fair value of the hedging instrument are taken directly to the consolidated statement of profit or loss for the period.

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Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.4 Due from banks

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

3.5 Loans and advances and Islamic financing

Loans and advances and Islamic financing are initially measured at fair value plus incremental direct transaction costs, and subsequently measured at their amortised cost using the effective interest method, except when the Group chooses to carry the loans and advances at fair value through profit or loss.

In addition to conventional banking products, the Group offers its customers certain Islamic financing products, which are approved by Sharia'a Supervisory Board. Islamic financing consists of the following:

Murabaha

An agreement whereby the Group sells to a customer, commodity or asset (subject asset) on a deferred payment basis, which the Group has purchased and acquired, based on a promise received from the customer to buy the item purchased according to specific terms and conditions. The selling price comprises the cost of the subject asset and an agreed profit margin. Income is recognised on an accrual basis adjusted by actual income when received.

Ijara

Ijara refers to lease of the asset, which the Group (Lessor) constructs or purchases as per customer (Lessee) request based on the promise to lease the asset for a fixed term against certain rent installment. Ijara can end by transferring the ownership of the asset to the lessee in case of Ijara Muntahia Bittamleek.

The Ijarah agreement specifies the leased asset, duration of the lease term, as well as, the basis for rental calculation and the timing of rental payment. The Lessee undertakes under this agreement to renew the lease periods and pay the relevant rental payment amounts as per the agreed schedule and applicable formula throughout the lease term.

The Lessor retains the ownership of the asset throughout the lease term. At the end of the lease term, upon fulfillment of all the obligations by the Lessee under the Ijarah agreement, the Lessor will sell the leased asset to the Lessee at nominal value based on a sale undertaking given by the Lessor.

Ijarah rentals accrue upon the commencement of the lease and continues throughout the lease term based on the outstanding fixed rental (which predominantly represent the cost of the leased asset).

Musharaka

An agreement whereby the Group and a customer contribute to a certain enterprise according to a diminishing arrangement ending up with the acquisition by the customer of the full ownership. The profit is shared as per the agreement set between both parties while the loss is shared in proportion to their shares of capital in the enterprise. In principle Musharaka profit is distributed on declaration / distribution by the managing partner.

Islamic financing products are initially recognised at fair value and subsequently measured at amortised cost, using the effective profit method, less any amounts written off, allowance for doubtful accounts and unearned income.

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

3.6 Investment securities

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

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

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For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.6 Investment securities (continued)

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

- 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.

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

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

3.7 Investment properties

The Group holds certain investment properties to earn rental income, for capital appreciation or both. The leased out or intended to lease out components have been classified as investment properties. Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred, if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at cost less any accumulated depreciation and accumulated impairment losses.

Depreciation is charged using straight line method over the useful life of the asset. Estimated useful life of buildings is 20 to 30 years.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property is determined by comparing the proceeds from disposal with the carrying amount and is recognised in the consolidated statement of profit or loss under 'other income' in the year of retirement or disposal.

Transfers are made to and from investment properties when, and only when there is change in use evidenced by ending or commencing of owner-occupation, ending or commencement of an operating lease of another party or ending of construction or development.

Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition, management has committed to the sale, and the sale is expected to be completed within one year from the date of classification.

Commercial Bank of Dubai PSC

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3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.8 Property and equipment

Property and equipment are stated at cost less accumulated depreciation and impairment losses except for granted land, which is stated at the market value at the date of grant.

Cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of replacing an item of property and equipment is recognised in the carrying value of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The day-to-day servicing expenses of property and equipment are recognised in the consolidated statement of profit or loss as incurred.

The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment. These are included in the consolidated statement of profit or loss.

Property and equipment is impaired if the carrying amount of the asset or its cash generating unit (CGU) exceed its recoverable amount. The impairment loss is recognised in the consolidated statement of profit or loss.

The cost of all property and equipment other than freehold land and capital work in progress is depreciated using the straight-line method over the following estimated useful lives:

Buildings	20 to 30 years
Leasehold improvements	5 years
Furniture, equipment and vehicles	3 to 5 years

Depreciation methods, useful lives and residual values are reassessed at each reporting date and prospectively adjusted if appropriate.

Capital work in progress is initially recorded at cost, and upon completion is transferred to the appropriate category of property and equipment and thereafter depreciated in accordance with the Group's policies.

3.9 Due to banks, notes and medium term borrowing

Amounts due to banks, notes and medium term borrowing are initially measured at fair value plus transaction costs, and are subsequently measured at amortised cost using the effective interest method.

3.10 Repurchase agreement

When the Group sells a financial asset and simultaneously enters into an agreement to repurchase the asset at a fixed price on a future date the agreement is accounted for as a term borrowing depending on period of the agreement, and the underlying asset continues to be recognised in the Group's financial statement.

3.11 Customer deposits and Islamic customer deposits

Customer deposits are initially recognised at fair value, being the fair value of the consideration received. After initial recognition, all deposits are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any transaction costs that are directly attributable to the acquisition or receipt of customer deposit.

The Islamic customer deposits are received by entering into following kinds of agreements:

Mudaraba

An agreement between the Group and a third party whereby one party would provide a certain amount of funds (Rab ul Mal) which the other party (Mudarib) would then invest in a specific enterprise or activity against a specific share in the profit. The Mudarib would bear the loss in case of default, negligence or violation of any of the terms and conditions of the Mudaraba. In principle Mudaraba profit is distributed on declaration/distribution by the Mudarib.

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3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.11 Customer deposits and Islamic customer deposits (continued)

Wakala

An agreement between Group and third party whereby one party (Muwakil) provides certain amount of funds which the other party (Wakil) would invest according to the terms and conditions of Wakala in return for a certain fee. The Wakil is obliged to return the invested amount in case of default, negligence or violation of any of the terms and conditions of the Wakala. The Wakeel may be granted any excess over and above a certain pre-agreed rate of return as a performance incentive. In principle, Wakala profit is distributed on declaration/distribution by the Wakil.

Islamic customer deposits are initially measured at fair value plus transaction costs, and subsequently measured at their amortised cost using the effective profit method.

3.12 Employees' terminal benefits

(i) Pension obligations

The Group operates a pension scheme in respect of eligible UAE national employees in compliance with the UAE Federal Law on Pensions and Social Security. Arrangements for benefits for overseas employees is made in accordance with local regulations and customs. Full provision is made for all accrued benefits.

(ii) Termination gratuity benefit scheme

In compliance with UAE Labour law, the Group has a termination gratuity benefit scheme covering all of its expatriate salaried employees who have been employed with the Group for more than one year. The provision for gratuity is recorded through the consolidated statement of profit or loss.

The present value of the gratuity obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for gratuities include the discount and mortality rate. Any changes in these assumptions will impact the carrying amount of gratuity obligations. The value of the gratuity obligations is based on the report submitted by an independent actuarial firm.

3.13 Share capital

The Group classifies capital instruments as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instruments.

3.14 Dividend on ordinary shares

Dividends payable on ordinary shares are recognised as a liability in the period in which they are approved by the Group's shareholders in the Annual General Meeting.

3.15 Offsetting

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

Income and expenses are presented on a net basis only when permitted under IFRSs, or of gains and losses arising from a group of similar transactions such as in the Group's trading activity.

3.16 Cash and cash equivalents

For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash on hand and balances with the Central Bank (excluding statutory reserve), and amounts due from and due to banks with original maturity of less than three months. Cash and cash equivalents are carried at amortised cost in the statement of financial position.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.17 Revenue recognition

(i) *Interest income and expense*

Interest income and expense for all interest bearing financial instruments except at FVPL, are presented in 'interest income' and 'interest expense' in the consolidated statement of profit or loss on an accrual basis using the effective interest rates of the financial assets or financial liabilities to which they relate. Interest income and expense for financial instruments at FVPL is recognised as 'Net gains from investments at fair value through profit or loss'.

Amortised cost and gross carrying amount

The 'amortised cost' of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured on initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any expected credit loss allowance.

The 'gross carrying amount of a financial asset' is the amortised cost of a financial asset before adjusting for any expected credit loss allowance.

Calculation of interest income and expense

The effective interest rate of a financial asset or financial liability is calculated on initial recognition of a financial asset or a financial liability. In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit-impaired) or to the amortised cost of the liability. The effective interest rate is revised as a result of periodic re-estimation of cash flows of floating rate instruments to reflect movements in market rates of interest. The effective interest rate is also revised for fair value hedge adjustments at the date amortisation of the hedge adjustment begins.

However, for financial assets that have become credit-impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit-impaired, then the calculation of interest income reverts to the gross basis.

For financial assets that were credit-impaired on initial recognition, interest income is calculated by applying the credit-adjusted effective interest rate to the amortised cost of the asset. The calculation of interest income does not revert to a gross basis, even if the credit risk of the asset improves.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.17 Revenue recognition (continued)

(ii) Income from Islamic financing and distributions to depositors

Income from Islamic financing is recognised in the consolidated statement of profit or loss using the effective profit method.

The calculation of the effective profit rate includes all fees paid or received, transaction costs, and discounts or premiums that are an integral part of the effective profit rate. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset.

Distribution to depositors (Islamic products) is calculated according to the Group's standard procedures and is approved by the Group's Sharia'a Supervisory Board.

(iii) Fees and commission

Fee income, which is not an integral part of the effective interest rate of a financial instrument, is earned from a diverse range of services provided by the Group 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 Group based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Group recognises revenue when it transfers control over a product or service to a customer.

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

Fee income is accounted for as follows:

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

Other fee and commission expenses relate mainly to credit card loyalty programme, commission and brokerage fees which are expensed as the services are received.

Fee income which forms an integral part of the effective interest rate of a financial instrument is recognised as an adjustment to the effective interest rate (for example, certain loan commitment fees) and recorded in 'Interest income'.

- **Asset management services**

The Group provides asset management services. Fees for asset management services are calculated based on a fixed percentage of the value of assets managed and deducted from the customer's account balance on a monthly basis.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.17 Revenue recognition (continued)

- **Customer loyalty programme**

The Group operates a rewards programme which allows customers to accumulate points when they purchase products on the Group'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. While some aspects of the programme are administered in-house, third party providers are used for certain other aspects of the programme.

In the case of the in-house administered aspects, the sale proceeds received are allocated between the products / services sold and the points issued. The proceeds allocated to the points are equal to their fair value. Fair value is determined by applying statistical techniques. The fair value of the points issued is deferred and recognised as revenue when the points are redeemed.

For aspects where third party providers are used, the consideration allocated to the awards credits collected on behalf of the third party are charged to the consolidated statement of profit or loss at the time of supplying the rewards.

- (iv) **Property related income**

Property related income includes rental income, which is recognised on a straight line basis over the term of the lease and is recorded under 'other income' in the consolidated statement of profit or loss.

- (v) **Dividend income**

Dividend income is recognised when the right to receive payment is established. The presentation of dividend income in the consolidated statement of profit or loss depends on the classification and measurement of the equity investment, i.e.:

- for equity instruments designated at FVOCI, dividend income is presented as Dividend Income; and
- for equity instruments at FVPL, dividend income is presented as 'Net gains from investments at FVPL'.

- (vi) **Share of profit of an associate**

Share of profit of an associate reflects the Group's share of the results of operations of the associate.

3.18 Provisions

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

3.19 Foreign currencies

Foreign currency transactions are recorded at rates of exchange ruling at the value dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date, are translated at the foreign exchange rate ruling at spot date.

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

Forward foreign exchange contracts are translated into AED at market rates of exchange ruling at the reporting date. Foreign exchange differences arising on translation are recognised in the consolidated statement of profit or loss.

Foreign currency differences arising on translation are generally recognized in the consolidated statement of profit or loss. However, foreign currency differences arising from the translation of qualifying cash flow hedges to the extent that the hedge is effective, are recognised in OCI.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.20 Leasing

The Group has applied IFRS 16 using the modified retrospective approach and therefore the comparative information has not been restated and continues to be reported under IAS 17.

Policy applicable from 1 January 2019

At inception of a contract, the Group assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Group uses the definition of a lease in IFRS 16.

This policy is applied to contracts entered into (or changed) on or after 1 January 2019.

i. Group acting as a lessee

At commencement or on modification of a contract that contains a lease component, the Group allocates consideration in the contract to each lease component on the basis of its relative standalone price. However, for leases of branches and office premises the Group has elected not to separate non-lease components and accounts for the lease and non-lease components as a single lease component.

The Group recognises a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove any improvements made to branches or office premises.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the end of the lease term. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Group's incremental borrowing rate. Generally, the Group uses its incremental borrowing rate as the discount rate.

The Group determines its incremental borrowing rate by analyzing its borrowings from various external sources and makes certain adjustments to reflect the terms of the lease and type of asset leased.

Lease payments included in the measurement of the lease liability comprise the following:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Group is reasonably certain to exercise, lease payments in an optional renewal period if the Group is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Group is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Group's estimate of the amount expected to be payable under a residual value guarantee, if the Group changes its assessment of whether it will exercise a purchase, extension or termination option or if there is a revised in-substance fixed lease payment.

When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Group presents right-of-use assets in 'property and equipment' and lease liabilities in 'other liabilities' in the statement of financial position.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.20 Leasing (continued)

Short-term leases and leases of low-value assets

The Group has elected not to recognise right-of-use assets and lease liabilities for leases of low-value assets and short-term leases, including leases of IT equipment. The Group recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

ii. Group acting as a lessor

At inception or on modification of a contract that contains a lease component, the Group allocates the consideration in the contract to each lease component on the basis of their relative stand-alone selling prices.

When the Group acts as a lessor, it determines at lease inception whether the lease is a finance lease or an operating lease.

To classify each lease, the Group makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the underlying asset. If this is the case, then the lease is a finance lease; if not, then it is an operating lease. As part of this assessment, the Group considers certain indicators such as whether the lease is for the major part of the economic life of the asset.

Policy applicable before 1 January 2019

For contracts entered into before 1 January 2019, the Group determined whether the arrangement was or contained a lease based on the assessment of whether:

- fulfilment of the arrangement was dependent on the use of a specific asset or assets; and
- the arrangement had conveyed a right to use the asset.

i. As a lessee

The Group did not have any finance leases under IAS 17.

Assets held under other leases were classified as operating leases and were not recognised in the Group's statement of financial position. Payments made under operating leases were recognised in profit or loss on a straight-line basis over the term of the lease. Lease incentives received were recognised as an integral part of the total lease expense, over the term of the lease.

ii. As a lessor

When the Group acted as a lessor, it determined at lease inception whether each lease was a finance lease or an operating lease.

To classify each lease, the Group made an overall assessment of whether the lease transferred substantially all of the risks and rewards incidental to ownership of the underlying asset. If this was the case, then the lease was a finance lease; if not, then it was an operating lease. As part of this assessment, the Group considered certain indicators such as whether the lease was for the major part of the economic life of the asset.

3.21 Fiduciary activities

The Group provides wealth management solutions to manage client assets. These assets are held in the Group's custody and are invested on behalf of the client in third party funds, and other securities like bonds and sukuk.

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.22 Acceptances

Acceptances arise when the Bank is under an obligation to make payments against documents drawn under letters of credit. Acceptances specify the amount of money, the date and the person to which the payment is due. After acceptance, the instrument becomes an unconditional liability (time draft) of the Bank and is therefore recognised as a financial liability in the consolidated statement of financial position with a corresponding contractual right of reimbursement from the customer recognised as a financial asset.

Acceptances have been considered within the scope of IFRS 9 - Financial Instruments and continued to be recognised as a financial liability in the consolidated statement of financial position with a contractual right of reimbursement from the customer as a financial asset.

3.23 Derivative product types

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

Forwards

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

Swaps

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

Options

Options are contractual agreements that convey the right, but not the obligation, to either buy or sell a specific amount of a commodity or financial instrument at a fixed price, either at a fixed future date or at any time within a specified period.

(i) Derivative related credit risk

Credit risk in respect of derivative financial instruments arises from the potential for a counterparty to default on its contractual obligations and is limited to the positive fair value of instruments that are favorable to the Group and potential future fluctuations. The majority of the fair value of favorable contracts (and therefore credit risk) is exposure to financial institutions.

(ii) Derivatives held or issued for trading purposes

Most of the Group's derivative trading activities relate to sales and position coverage. Sales activities involve offering products to customers at competitive prices in order to enable them to transfer, modify or reduce current and expected risks.

Interest rate derivatives trading are conducted under Board approved limits.

Derivatives are initially recognised in the consolidated financial statements at cost being its fair value, for the premium received / paid. All derivatives are carried at their fair values as assets where the fair values are positive and as liabilities where the fair values are negative. Subsequent to initial recognition derivatives (held for trading) are measured at fair value with fair value changes recognised in the consolidated statement of profit or loss.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.24 Earnings per share

The Group 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 of the Bank by the weighted average number of ordinary shares outstanding during the year. 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.

3.25 Segment reporting

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components, whose operating results are reviewed regularly by the Executive Committee to make decisions about resources allocated to the segment and assess its performance, and for which distinct financial information is available. Segment results that are reported to the Executive Committee include items directly attributable to a segment as well as those that can be allocated on a reasonable basis.

3.26 Related parties

An entity is considered related party of the Group if:

- a) A person or a close member of that person's family is related to the Group if that person:
 - i. has control or joint control of the Group;
 - ii. has significant influence over the Group; or
 - iii. is a member of the key management personnel of the Group.
- b) An entity is related to a Group if any of the following conditions applies:
 - i. The entity and the Group are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - iii. Both entities are joint ventures of the same third party.
 - iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.
 - v. The entity is controlled or jointly controlled by a person identified in (a).
 - vi. A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).
- c) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity.

Other than the transactions disclosed in note 33, the Group enters into transactions with other Government entities. In accordance with the exemption available in the revised IAS 24, these transactions with such related Government entities are not collectively or individually significant and have not been disclosed.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

3 SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

3.27 Impairment of non-financial assets

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

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

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

4 USE OF ESTIMATES AND JUDGEMENTS

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

Critical judgements in applying the Group's accounting policies

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

4.1 Going concern

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

4.2 Impairment of non-financial assets

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

4 USE OF ESTIMATES AND JUDGEMENTS (CONTINUED)

4.3 Financial asset classification

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

4.4 Significant increase in credit risk

As explained in note 3.1.1 (e), ECL are measured as an allowance equal to 12-month ECL for Stage 1 assets, or lifetime ECL assets for Stage 2 or Stage 3 assets. An asset moves to Stage 2 when its credit risk has increased significantly since initial recognition. IFRS 9 does not define what constitutes a significant increase in credit risk. In assessing whether the credit risk of an asset has significantly increased the Group takes into account qualitative and quantitative reasonable and supportable forward looking information.

4.5 Establishing groups of assets with similar credit risk characteristics

When ECLs are measured on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics. Refer to note 3.1.1 (e) for details of the characteristics considered in this judgement. The Group monitors the appropriateness of the credit risk characteristics on an ongoing basis to assess whether they continue to be similar. This is required in order to ensure that should credit risk characteristics change there is appropriate re-segmentation of the assets. This may result in new portfolios being created or assets moving to an existing portfolio that better reflects the similar credit risk characteristics of that group of assets. Re-segmentation of portfolios and movement between portfolios is more common when there is a significant increase in credit risk (or when that significant increase reverses) and so assets move from 12-month to lifetime ECLs, or vice versa, but it can also occur within portfolios that continue to be measured on the same basis of 12-month or lifetime ECLs but the amount of ECL changes because the credit risk of the portfolios differ.

4.6 Models and assumptions used

The Group uses various models and assumptions in measuring fair value of financial assets as well as in estimating ECL. Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk. See note 3.1.1 (e) for more details on ECL.

4.7 Key sources of estimation uncertainty

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

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements

For the year ended 31 December 2019

5 APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS "IFRS"

5.1 Relevant new and revised IFRS applied with no material effect on the consolidated financial statements

The following new and revised IFRS have been adopted in these consolidated financial statements. The application of these new and revised IFRS has not had any material impact on the amounts reported for the current and prior periods.

	<u>Effective for annual periods</u> <u>beginning on or after</u>
(a) IFRS 16 Leases	1 January 2019
(b) Annual improvements 2015-2017 cycle	1 January 2019
(c) Prepayment features with Negative Compensation - Amendments to IFRS 9	1 January 2019
(d) Long-term interests in Associates and Joint Ventures - Amendments to IAS 28	1 January 2019
(e) Plan Amendment, Curtailments or Settlement - Amendments to IAS 19	1 January 2019

Other than the above, there are no other significant IFRSs and amendments that were effective for the first time for the financial year beginning on or after 1 January 2019.

5.2 Relevant new and revised IFRS issued but not yet effective

The Group has not applied the following new and revised IFRS, amendments and interpretations that have been issued but not yet effective:

	<u>Effective for annual periods</u> <u>beginning on or after</u>
(a) Definition of a Business – Amendments to IFRS 3	1 January 2020
(b) Interest Rate Benchmark Reform – Amendments to IFRS 9, IAS 39 and IFRS 7	1 January 2020
(c) Definition of Material – Amendments to IAS 1 and IAS 8	1 January 2020
(d) The Conceptual Framework for Financial Reporting	1 January 2020
(e) IFRS 17 Insurance Contracts	1 January 2021

Management anticipates that these IFRS and amendments will be adopted in the consolidated financial statements in the initial period when they become mandatorily effective. The impact of these standards and amendments are currently being assessed by the management.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

6 FINANCIAL ASSETS AND LIABILITIES

6.1 Financial assets and liabilities classification

The table below sets out the Group's financial assets and liabilities classification in accordance with the categories of financial instruments in IFRS 9:

	Fair value through profit or loss	Fair value through OCI	Amortised cost	Total carrying amount
	AED'000	AED'000	AED'000	AED'000
31 December 2019				
Cash and balances with Central Bank	-	-	12,592,641	12,592,641
Due from banks, net	-	-	2,427,735	2,427,735
Loans and advances and Islamic financing, net	-	-	60,180,810	60,180,810
Investment securities	253,861	5,359,426	-	5,613,287
Bankers acceptances	-	-	5,346,819	5,346,819
Other assets, net	485,029	-	486,708	971,737
Total financial assets	738,890	5,359,426	81,034,713	87,133,029
Due to banks	-	-	4,166,589	4,166,589
Customer deposits and Islamic customer deposits	-	-	63,334,333	63,334,333
Notes and medium term borrowing	-	-	3,231,072	3,231,072
Due for trade acceptances	-	-	5,346,819	5,346,819
Other liabilities	407,228	-	1,293,923	1,701,151
Total financial liabilities	407,228	-	77,372,736	77,779,964

	Fair value through profit or loss	Fair value through OCI	Amortised cost	Total carrying amount
	AED'000	AED'000	AED'000	AED'000
31 December 2018				
Cash and balances with Central Bank	-	-	8,682,322	8,682,322
Due from banks, net	-	-	971,280	971,280
Loans and advances and Islamic financing, net	-	-	50,944,947	50,944,947
Investment securities	-	6,751,150	-	6,751,150
Bankers acceptances	-	-	5,266,428	5,266,428
Other assets, net	104,556	-	596,797	701,353
Total financial assets	104,556	6,751,150	66,461,774	73,317,480
Due to banks	-	-	2,762,944	2,762,944
Customer deposits and Islamic customer deposits	-	-	53,165,030	53,165,030
Notes and medium term borrowing	-	-	2,609,944	2,609,944
Due for trade acceptances	-	-	5,266,428	5,266,428
Other liabilities	82,540	-	909,964	992,504
Total financial liabilities	82,540	-	64,714,310	64,796,850

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

6 FINANCIAL ASSETS AND LIABILITIES (CONTINUED)

6.2 Fair value measurement – Fair value hierarchy:

The table below shows categorization of fair value of financial assets and liabilities into different levels of the fair value hierarchy:

	Level 1 AED'000	Level 2 AED'000	Level 3 AED'000	Total fair value AED'000	Carrying value AED'000
31 December 2019					
Investments					
Equity instruments and funds	48,786	-	254,030	302,816	302,816
Fixed and floating rate securities	5,310,471	-	-	5,310,471	5,310,471
Positive market value of forward foreign exchange contracts and other derivatives					
Fair value through profit or loss	-	484,145	-	484,145	484,145
Held for fair value hedge	-	-	-	-	-
Held for cash flow hedge	-	884	-	884	884
Negative market value of forward foreign exchange contracts and other derivatives					
Held for trading	-	(398,070)	-	(398,070)	(398,070)
Held for fair value hedge	-	(5,582)	-	(5,582)	(5,582)
Held for cash flow hedge	-	(3,576)	-	(3,576)	(3,576)
Liabilities at amortized cost					
Notes and medium term borrowings	(1,488,270)	(1,763,153)	-	(3,251,423)	(3,231,072)
	3,870,987	(1,685,352)	254,030	2,439,665	2,460,016

31 December 2018

Investments					
Equity instruments and funds	72,324	4,598	5,176	82,098	82,098
Fixed and floating rate securities	6,669,052	-	-	6,669,052	6,669,052
Positive market value of forward foreign exchange contracts and other derivatives					
Fair value through profit or loss	-	104,243	-	104,243	104,243
Held for fair value hedge	-	313	-	313	313
Negative market value of forward foreign exchange contracts and other derivatives					
Held for trading	-	(74,303)	-	(74,303)	(74,303)
Held for fair value hedge	-	(1,092)	-	(1,092)	(1,092)
Held for cash flow hedge	-	(7,145)	-	(7,145)	(7,145)
Liabilities at amortized cost					
Notes and medium term borrowings	(1,470,596)	(1,143,241)	-	(2,613,837)	(2,609,944)
	5,270,780	(1,116,627)	5,176	4,159,329	4,163,222

The carrying values of the financial assets and liabilities (that are not stated at fair value) are not significantly different from their fair values.

During the year there were no transfers between Level 1, Level 2 and level 3 of the fair value hierarchy above. Further, there has been no change in the valuation techniques in relation to valuation of financial instruments during the current or prior year.

During the year the Bank has acquired some unquoted equity investments in settlement of debt which are treated as Level 3. These investments are measured at fair value through profit or loss with reference to the net asset values of the respective funds.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

7 CASH AND BALANCES WITH CENTRAL BANK

	2019	2018
	AED'000	AED'000
Cash on hand	430,163	449,843
Balances with Central Bank U.A.E		
- Clearing account balances	3,248,515	732,048
- Statutory reserves	3,713,963	3,200,431
- Negotiable certificates of deposit	5,200,000	4,300,000
	<u>12,592,641</u>	<u>8,682,322</u>

Statutory reserves are not available for use in the Group's day to day operations and cannot be withdrawn without the approval of the Central Bank. The level of reserves required changes periodically in accordance with business requirements and the directives of the Central Bank.

Cash and balances with Central Bank is classified under stage 1 as per IFRS 9. There are no expected credit losses and hence no provision has been recognised.

8 DUE FROM BANKS, NET

	2019	2018
	AED'000	AED'000
Current and demand deposits	1,459,479	550,754
Overnight, call and short notice	611,368	114,071
Loans to banks	360,021	309,590
Gross due from banks	<u>2,430,868</u>	<u>974,415</u>
Allowances for impairment losses	(3,133)	(3,135)
Net due from banks	<u>2,427,735</u>	<u>971,280</u>
Within the U.A.E.	178,499	36,746
Outside the U.A.E.	<u>2,249,236</u>	<u>934,534</u>
	<u>2,427,735</u>	<u>971,280</u>

Due from banks is classified under stage 1 as per IFRS 9. The expected credit loss as at 31 December 2019 is AED 3,133 thousand (31 December 2018: AED 3,135 thousand).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

9 LOANS AND ADVANCES AND ISLAMIC FINANCING, NET

The composition of the loans and advances and Islamic financing portfolio is as follows:

	2019 AED'000	2018 AED'000
Loans and advances		
Overdrafts	7,018,523	6,155,390
Loans	40,327,233	35,547,904
Advances against letters of credit and trust receipts	3,219,631	3,180,672
Bills discounted	2,089,718	1,456,452
Gross loans and advances	52,655,105	46,340,418
Islamic financing		
Murabaha and Tawaruq	4,503,190	2,792,472
Ijara	6,792,880	4,810,392
Others	88,086	114,658
Gross Islamic financing	11,384,156	7,717,522
Gross loans and advances and Islamic financing	64,039,261	54,057,940
Allowances for impairment losses	(3,858,451)	(3,112,993)
Net loans and advances and Islamic financing	60,180,810	50,944,947

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

	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
Gross exposure at 1 January 2019	45,693,693	4,517,906	3,846,341	54,057,940
Net transfers between stages	(3,944,160)	3,034,794	909,366	-
Net additions / (repayments)	10,599,229	(354,270)	22,658	10,267,617
Amounts written off	-	-	(286,296)	(286,296)
At 31 December 2019	52,348,762	7,198,430	4,492,069	64,039,261
	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
ECL allowance at 1 January 2019	685,655	335,311	2,092,027	3,112,993
Net transfers between stages	2,934	(43,023)	40,089	-
Net (reversals) / impairment charge	(170,975)	316,864	971,256	1,117,145
Recoveries	-	-	(85,391)	(85,391)
Amounts written off	-	-	(286,296)	(286,296)
At 31 December 2019	517,614	609,152	2,731,685	3,858,451
	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
Gross exposure at 1 January 2018	41,515,604	3,819,155	4,850,688	50,185,447
Net transfers between stages	(1,855,020)	1,676,020	179,000	-
Net additions / (repayments)	6,033,109	(977,269)	(29,973)	5,025,867
Amounts written off	-	-	(1,153,374)	(1,153,374)
At 31 December 2018	45,693,693	4,517,906	3,846,341	54,057,940
	Stage 1 AED'000	Stage 2 AED'000	Stage 3 AED'000	Total AED'000
ECL allowance at 1 January 2018	934,633	282,946	2,080,891	3,298,470
Net transfers between stages	(31,271)	4,917	26,354	-
Net (reversals) / impairment charge	(217,707)	47,448	1,167,491	997,232
Recoveries	-	-	(29,335)	(29,335)
Amounts written off	-	-	(1,153,374)	(1,153,374)
At 31 December 2018	685,655	335,311	2,092,027	3,112,993

The net reversals/ impairment charge are inclusive of interest in suspense.

The economic sector composition of the loans and advances and Islamic financing is set out in note 35 (b).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

9 LOANS AND ADVANCES AND ISLAMIC FINANCING, NET (CONTINUED)

The Group has hedged the fair value of certain fixed rate loans and advances and Islamic financing. The carrying value of these loans and advances and Islamic financing is AED 148.6 million (2018: AED 166 million). Net positive fair value of the hedged component is AED 2.9 million (2018: net positive fair value of AED 128 thousand).

10 INVESTMENT SECURITIES

	UAE AED'000	GCC AED'000	International AED'000	Total AED'000
2019				
Held at fair value through profit & loss				
Unquoted equity instruments	-	-	253,861	253,861
Held at fair value through other comprehensive income				
Quoted equity instruments	48,786	-	-	48,786
Unquoted equity instruments and fund	-	-	169	169
Fixed rate securities				
- Government	1,702,870	650,064	243,674	2,596,608
- Others	1,157,994	377,553	568,723	2,104,270
Floating rate non-government securities	330,560	-	279,033	609,593
	3,240,210	1,027,617	1,345,460	5,613,287
2018				
Held at fair value through other comprehensive income				
Quoted equity instruments	72,324	-	-	72,324
Unquoted equity instruments and fund	5,175	4,400	199	9,774
Fixed rate securities				
- Government	2,269,581	999,584	366,950	3,636,115
- Others	1,459,601	403,792	773,499	2,636,892
Floating rate non-government securities	183,038	-	213,007	396,045
	3,989,719	1,407,776	1,353,655	6,751,150

Included in fixed and floating rate securities held at fair value through other comprehensive income securities is an amount of AED 1.4 billion (31 December 2018: AED 1.4 billion), pledged under repurchase agreements with banks (note 17).

Net gains from sale of debt investments at fair value through other comprehensive income amounted to AED 53.1 million (2018: AED 6.9 million)

10.1 Held at fair value through other comprehensive income fixed and floating rate securities

The below table shows the rating of fixed and floating rate securities:

	2019 AED'000	2018 AED'000
Rated Aaa to Aa3	1,255,523	1,791,588
Rated A1 to A3	2,085,579	2,304,980
Rated Baa1 to Baa3	1,014,157	1,405,448
Rated below Baa3 or Unrated - Government	855,610	1,076,323
Rated below Baa3 - others	99,602	90,713
	5,310,471	6,669,052

The above represents approved ratings from External Credit Assessment Institutions (ECAIs) as per BASEL III guidelines.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

11 INVESTMENT IN AN ASSOCIATE

Equity accounting was applied using management information available at the date of reporting.

The following is the aggregated financial information of the associate:

	2019 AED'000	2018 AED'000
At 1 January	84,842	81,053
Share of profit of associate	4,318	9,621
Dividends received	(3,992)	(3,992)
Share of Directors' remuneration of associate	(424)	(447)
Other equity adjustments	383	(1,393)
At 31 December	85,127	84,842

	2019 AED'000	2018 AED'000
Assets	1,262,345	1,320,185
Liabilities	782,757	842,201
Net assets	479,588	477,984
Revenue	51,514	57,851

12 INVESTMENT PROPERTIES, NET

The movement in investment properties during the year is as follows:

	2019 AED'000	2018 AED'000
Cost		
At 1 January	380,780	338,683
Transfers from property and equipment	29,700	42,097
Disposals	(51,476)	-
At 31 December	359,004	380,780
Depreciation / Impairment		
At 1 January	166,360	143,703
Charge for the year	7,824	9,919
Transfers from property and equipment	5,133	12,738
Disposals	(22,531)	-
Impairment	3,322	-
At 31 December	160,108	166,360
Net book value at 31 December	198,896	214,420

Investment properties comprises buildings. Rental income amounting to AED 19.6 million (2018: AED 19.3 million) from investment properties leased under operating lease is recorded in other income.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

12 INVESTMENT PROPERTIES, NET (CONTINUED)

During the year ended 31 December 2019 the Group has carried out external valuations of material investment properties. The valuations are carried out by professional valuers who hold recognised and relevant professional qualification and have recent experience in the location and category of the investment properties being valued. The valuations were based on income (investment) method of valuation. To value the investment properties, the passing rental income and estimated market rental income are used. Any significant movement in the assumptions used for the fair valuation of investment properties such as yield, rental growth, vacancy rate etc. is expected to result in significantly lower / higher fair value of these assets. As a result of the above impairment exercise, the Group has recognised an impairment of AED 3,322 thousand (2018: AED nil), which has been charged to the consolidated statement of profit or loss and is classified as 'impairment allowance on investment property'.

13 PROPERTY AND EQUIPMENT

	Freehold land and buildings	Leasehold improvements	Furniture, equipment & vehicles	Capital work in progress (CWIP)	Total
Cost	AED'000	AED'000	AED'000	AED'000	AED'000
At 1 January 2019	367,053	64,347	402,668	45,134	879,202
Additions during the year	12	3,402	3,186	20,691	27,291
Transfers	(29,700)	-	51,606	(51,606)	(29,700)
Disposals / write off	(25,218)	(18,076)	(626)	(1,128)	(45,048)
At 31 December 2019	312,147	49,673	456,834	13,091	831,745
Depreciation					
At 1 January 2019	164,690	45,851	325,568	-	536,109
Transfers	(5,133)	-	-	-	(5,133)
Charge for the year	9,849	6,671	46,055	-	62,575
On disposals	(22,022)	(12,843)	(524)	-	(35,389)
At 31 December 2019	147,384	39,679	371,099	-	558,162
Net book values at 31 December 2019	164,763	9,994	85,735	13,091	273,583

	Freehold land and buildings	Leasehold improvements	Furniture, equipment & vehicles	Capital work in progress (CWIP)	Total
Cost	AED'000	AED'000	AED'000	AED'000	AED'000
At 1 January 2018	409,150	62,802	364,837	55,211	892,000
Additions during the year	-	1,908	1,844	40,070	43,822
Transfers	(42,097)	(288)	48,239	(47,951)	(42,097)
Disposals / write off	-	(75)	(12,252)	(2,196)	(14,523)
At 31 December 2018	367,053	64,347	402,668	45,134	879,202
Depreciation					
At 1 January 2018	168,057	38,700	301,539	-	508,296
Transfers	(12,738)	-	-	-	(12,738)
Charge for the year	9,371	7,151	36,532	-	53,054
On disposals	-	-	(12,503)	-	(12,503)
At 31 December 2018	164,690	45,851	325,568	-	536,109
Net book values at 31 December 2018	202,363	18,496	77,100	45,134	343,093

The Group assessed whether there is an indication that an asset may be impaired and concluded that there was no indication of impairment.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

14 OTHER ASSETS, NET

	2019	2018
	AED'000	AED'000
Interest receivable	396,149	373,932
Accounts receivable and prepayments	116,991	253,780
Positive mark to market value of derivatives (note 31)	485,029	104,556
Properties acquired in settlement of debt	351,824	110,796
	<u>1,349,993</u>	<u>843,064</u>

During the year, the Bank has acquired certain properties against partial settlement of a debt and sold some properties acquired in similar settlement of debt during prior years. These properties are classified as 'properties acquired in settlement of debt'.

15 DUE TO BANKS

	2019	2018
	AED'000	AED'000
Current and demand deposits	181,476	187,304
Term borrowings	3,985,113	2,575,640
	<u>4,166,589</u>	<u>2,762,944</u>

16 CUSTOMER DEPOSITS AND ISLAMIC CUSTOMER DEPOSITS

	2019	2018
	AED'000	AED'000
Customer deposits		
Current and demand accounts	18,139,152	15,158,944
Savings accounts	2,749,921	2,422,298
Time deposits	27,967,596	23,393,862
	<u>48,856,669</u>	<u>40,975,104</u>

Islamic customer deposits

Current and demand accounts	3,495,503	2,508,574
Mudaraba savings accounts	583,368	591,166
Investment and Wakala deposits	10,398,793	9,090,186
	<u>14,477,664</u>	<u>12,189,926</u>

Total customer deposits and Islamic customer deposits

	<u>63,334,333</u>	<u>53,165,030</u>
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	2019	2018
	AED'000	AED'000
By sector:		
Government	15,181,747	13,743,546
Corporate	32,787,750	25,555,410
Personal	15,364,836	13,866,074
	<u>63,334,333</u>	<u>53,165,030</u>

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

17 NOTES AND MEDIUM TERM BORROWINGS

		31 December 2018 AED'000	Cash flow Changes AED'000	Non cash flow Changes AED'000	31 December 2019 AED'000
Syndicated loan	17.1	-	619,591	321	619,912
Repurchase agreements - I	17.2	551,442	-	-	551,442
Repurchase agreements - II	17.2	591,799	-	-	591,799
Euro medium term notes - II	17.3	1,466,703	-	1,216	1,467,919
Total		2,609,944	619,591	1,537	3,231,072

		31 December 2017 AED'000	Cash flow Changes AED'000	Non cash flow Changes AED'000	31 December 2018 AED'000
Syndicated loan	17.1	1,645,826	(1,652,850)	7,024	-
Repurchase agreements - I	17.2	551,442	-	-	551,442
Repurchase agreements - II	17.2	591,799	-	-	591,799
Euro medium term notes - I	17.3	1,835,376	(1,836,500)	1,124	-
Euro medium term notes - II	17.3	1,465,220	-	1,483	1,466,703
Total		6,089,663	(3,489,350)	9,631	2,609,944

17.1 Syndicated loan

In June 2016, the Group entered into a club deal of USD 450 million (AED 1,653 million) for a term of 3 years with an option to roll over on a quarterly or semi-annual basis maturing in June 2019. The arrangement was prepaid in December 2018.

In August 2019, the Group entered into a club deal of USD 170 million (AED 624.4 million) for a term of 5 years with an option to roll over on a semi-annual basis maturing in August 2024.

17.2 Repurchase agreements

In July 2012, the Group entered into Repo transactions to obtain financing against the sale of certain debt securities, amounting to USD 150.1 million (AED 551.4 million) with arrangements to repurchase them at a fixed future date in July 2017. In June 2016 the arrangement of repurchase has been extended for additional five years up until July 2022.

In June 2016, the Group entered into additional Repo transactions to obtain financing against the sale of certain debt securities, amounting to USD 161.1 million (AED 591.8 million) with arrangements to repurchase them at a fixed future date in June 2021.

As at 31 December 2019, the fair value of the debt securities, which have been pledged under these repurchase agreements with banks, amounts to AED 1,428.4 million (USD 388.9 million) (2018: AED 1,383 million (USD 376.5 million)) (note 10).

17.3 Euro medium term notes

In 2013, CBD activated its Euro Medium Term Note (EMTN) program. These notes can be issued by way of private or public placements and in each case on a syndicated or non-syndicated basis. These notes can be priced at fixed rate, floating rate or can be index linked. The maximum issuance under the program was USD 2 billion (AED 7.3 billion). At the Annual General Meeting (AGM) held on 28 February 2016 shareholders approved the increase of the program limit up to a total of USD 3 billion (AED 11 billion).

In May 2013, CBD issued USD 500 million (AED 1,836.5 million) of conventional bonds. These notes were priced at 3.375 per cent fixed rate. These had matured on 21 May 2018.

In November 2015, CBD issued USD 400 million (AED 1,469.2 million) of conventional bonds. These notes were priced at 4 per cent fixed rate and mature on 17 November 2020.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

18 OTHER LIABILITIES

	2019	2018
	AED'000	AED'000
Interest payable	459,691	378,938
Employees' terminal benefits	50,826	60,648
Accounts payable	320,323	220,151
Accrued expenses	137,202	133,632
Manager cheques	325,881	116,595
Unearned fee income and deferred credits	72,357	85,970
Negative mark to market value of derivatives (note 31)	407,228	82,540
	<u>1,773,508</u>	<u>1,078,474</u>

Based on the actuarial computation of employees' terminal benefits, the obligation under the defined benefit scheme is AED 50.8 million (2018: AED 60.6 million). The actuarial gain for the year ended 31 December 2019 amounting to AED 3.0 million (2018: AED 1.1 million loss) has been recognized directly in other comprehensive income under Actuarial gain / (loss) on retirement benefits obligations. The key assumptions used are normal retirement age, expected increase in salary and discount rate.

19 EQUITY

19.1 Share capital

The fully paid up and authorised ordinary share capital as at 31 December 2019 comprised 2,802,733,968 ordinary shares of AED 1 each (31 December 2018: 2,802,733,968 shares of AED 1 each). There was no movement in authorised ordinary share capital during the period.

19.2 Legal and statutory reserve

The Group's Article of Association in compliance with the Decretal Federal Law No. (14) of 2018 require a minimum of 10% of annual net profit to be transferred to non-distributable legal and statutory reserve, until such time as this reserve equals 50% of share capital. During the year no transfer to legal and statutory reserve was required (2018: nil) to meet the minimum regulatory requirement. The legal and statutory reserve is not available for distribution except under the circumstances stipulated by the relevant laws.

19.3 General reserve

The Group's new Articles of Association adopted by the General Assembly of Shareholders in its meeting held on 26 June 2016 deleted the requirement for the general reserve. Therefore, there is no requirement to transfer 10% of the annual net profit to the general reserve. The previous Group's Articles of Association, required a minimum of 10% of the annual net profit to be transferred to general reserve until such time as this reserve equals 50% of share capital. The disposition of the general reserve shall be in accordance with a resolution made by the Board of Directors.

19.4 Capital reserve

This reserve represents the value of the granted land at the date of grant, and is not available for distribution to the shareholders.

19.5 Fair value reserve

This represents the net change in the fair values of OCI investments, derivative instruments designated as cash flow hedge instruments held by the Group at reporting date and actuarial changes on retirement benefits obligations. This reserve is not available for distribution to the shareholders until realised.

19.6 Proposed distribution

As of the date of approving the consolidated financial statements, the Board of Directors' proposed a cash dividend of 20.70% (2018: 20.70%).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

20 INTEREST INCOME AND INCOME FROM ISLAMIC FINANCING

	2019	2018
	AED'000	AED'000
Interest income		
Loans and advances	2,350,108	2,140,234
Negotiable certificates of deposit with the Central Bank	102,131	52,249
Due from banks	33,762	31,494
Investment securities		
- Debt securities at amortised cost bonds	-	713
- Debt securities at FVOCI	205,692	216,657
	2,691,693	2,441,347
Income from Islamic financing		
Murabaha and Tawaruq	225,955	165,879
Ijara	259,841	239,987
	485,796	405,866
Total interest income and income from Islamic financing	3,177,489	2,847,213

Interest income is recognised using the effective interest rate.

21 INTEREST EXPENSE AND DISTRIBUTION TO ISLAMIC DEPOSITORS

	2019	2018
	AED'000	AED'000
Interest expense		
Due to banks	20,812	22,872
Customer deposits	717,989	532,723
Notes and medium term borrowings	195,011	197,668
	933,812	753,263
Distribution to Islamic depositors		
Islamic customer deposits	278,095	182,727
	278,095	182,727
Total interest expense and distribution to Islamic depositors	1,211,907	935,990

Distribution to Islamic depositors represents the share of income allocated to Islamic depositors of the Group. The allocation and distribution is approved by the Group's Sharia'a Supervisory Board.

22 NET FEES AND COMMISSION INCOME

	2019	2018
	AED'000	AED'000
Lending activities	233,941	181,435
Trade finance activities	191,059	152,230
Account operating activities	263,098	207,344
Cards income and brokerage fees	102,875	106,479
	790,973	647,488
Cards, commissions and brokerage expenses	(89,819)	(69,283)
	701,154	578,205

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

23 NET GAINS FROM INVESTMENTS AT FAIR VALUE THROUGH PROFIT OR LOSS

	2019 AED'000	2018 AED'000
Net realised gains on sale of investments at fair value through profit or loss	1,412	650
	<u>1,412</u>	<u>650</u>

24 OTHER INCOME

Other income includes profit on sale of investment properties or assets held for sale acquired in settlement of debt of AED 79.1 million (2018: 29.5 million)

25 STAFF AND OTHER EXPENSES

Staff and other expenses include staff related expenses of AED 613.3 million (2018: AED 593 million) and sitting fees paid to directors for attending committee meetings during the year ended 31 December 2019 of AED 4.3 million (2018: AED 3.1 million) and corporate social responsibility (CSR) related expenses of AED 1.2 million (2018: AED 0.9 million).

26 LEASE COMMITMENTS

Group as lessee

General and administrative expenses include rental expense of AED 16.4 million (2018: AED 15.9 million). Future minimum lease payments under non-cancellable leases as at 31 December are, as follows:

	2019 AED'000	2018 AED'000
Less than 1 year	8,313	11,256
From 1 year to 5 years	6,339	16,996
	<u>14,652</u>	<u>28,252</u>

27 BASIC AND DILUTED EARNINGS PER SHARE

Basic earnings per share have been computed using the net profit AED 1,400,190 thousand (2018: 1,162,111 thousand) divided by the weighted average number of ordinary shares outstanding 2,802,733,968 (31 December 2018: 2,802,733,968).

Diluted earnings per share as of 31 December 2019 and 31 December 2018 are equivalent to basic earnings per share as no new shares have been issued that would impact earnings per share when executed.

28 CASH AND CASH EQUIVALENTS

Cash and cash equivalents included in the consolidated statement of cash flows comprise the following consolidated statement of financial position amounts:

	2019 AED'000	2018 AED'000
Cash on hand	430,163	449,843
Balances with the Central Bank U.A.E.	3,248,515	732,048
Negotiable certificates of deposit with the Central Bank U.A.E. with original maturity less than three months	2,800,000	2,600,000
Due from banks with original maturity of less than three months	2,070,847	664,825
	<u>8,549,525</u>	<u>4,446,716</u>
Due to banks with original maturity of less than three months	(1,209,160)	(1,131,382)
	<u>7,340,365</u>	<u>3,315,334</u>

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

29 CONTINGENT LIABILITIES AND COMMITMENTS

Contingent liabilities represent credit-related commitments to extend letters of credit and guarantees which are designed to meet the requirements of the Group's customers toward third parties. Undrawn commitments represent the Group's commitments towards approved un-drawn credit facilities. The amount of contingent liabilities reflected below represent the maximum accounting loss that would be recognised at the reporting date if counterparties failed completely to perform as contracted.

	2019	2018
	AED'000	AED'000
Contingent liabilities:		
Letters of credit	2,226,939	1,221,648
Letters of guarantee	12,255,363	10,804,478
	14,482,302	12,026,126
Undrawn commitments to extend credit	14,092,002	13,420,771
Capital commitments:		
Capital expenditure commitments	30,689	46,615
Total contingent liabilities and commitments	28,604,993	25,493,512

30 FIDUCIARY ASSETS

Assets held under fiduciary capacity on behalf of clients amounted to AED 1,286.7 million (2018: AED 838.1 million).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

31 DERIVATIVES

The following table shows the positive and negative fair values of derivative financial instruments at the reporting date, together with the notional amounts, analyzed by terms to maturity. The notional amount is the value of the derivative's underlying asset and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at the year end and therefore, are neither indicative of the Group's exposure to credit risk nor market risk. Credit risk on derivatives is limited to its positive fair value if any.

	Positive market value AED'000	Negative market value AED'000	Notional amount AED'000	Less than three months AED'000	From three months to one year AED'000	From one year to five years AED'000	Over Five years AED'000
31 December 2019							
Cash flow hedge instruments	884	3,576	92,716	-	30,905	61,811	-
Fair value hedge instruments	-	5,582	182,822	-	37,489	73,460	71,873
Forward foreign exchange contracts and other derivatives assets	484,145	-	14,569,390	4,858,982	1,188,567	5,154,149	3,367,692
Forward foreign exchange contracts and other derivatives liabilities	-	398,070	14,412,712	4,198,582	1,426,051	5,442,125	3,345,954
	485,029	407,228	29,257,640	9,057,564	2,683,012	10,731,545	6,785,519
31 December 2018							
Cash flow hedge instruments	-	7,145	94,626	-	-	94,626	-
Fair value hedge instruments	313	1,092	200,331	-	-	115,950	84,381
Forward foreign exchange contracts and other derivatives assets	104,243	-	9,244,749	3,200,542	759,197	3,312,755	1,972,255
Forward foreign exchange contracts and other derivatives liabilities	-	74,303	9,620,796	3,140,194	1,528,493	3,008,451	1,943,658
	104,556	82,540	19,160,502	6,340,736	2,287,690	6,531,782	4,000,294

Cash-flow hedge instruments include interest rate and cross currency swaps. Fair value hedge instruments include interest rate swaps.

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Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

32 SEGMENTAL REPORTING

The primary format, business segments, is based on the Group's management and internal reporting structure that are regularly reviewed by the Executive Committee in order to allocate resources to the segment and to assess its performance.

Business segments pay to and receive interest from the Treasury to reflect the allocation of funding costs.

Business segments

Corporate banking	Includes loan and other credit facilities, deposits, trade finance products and e-commerce solutions to large corporate clients (including Government related entities).
Commercial banking	Includes loans, working capital financing, trade finance and deposits products to commercial (mid-sized and small) clients.
Personal banking	Includes current accounts, easy access saving accounts, fixed rate deposit accounts, personal loans, overdraft facilities, vehicle finance, mortgage products, loans and other credit facilities to small business and retail clients.
Treasury and investments	Undertakes balance sheet management deals and manages the Group's proprietary investment portfolio. It also has derivatives for trading and risk management purposes.

Interest is charged or credited to business segments and branches to match funding at transfer pricing rates which approximate the cost of funds.

Geographical

The Group operates in one geographic area, the United Arab Emirates.

	Corporate banking AED'000	Commercial banking AED'000	Personal banking AED'000	Treasury & Investments AED'000	Total AED'000
2019					
Assets	42,639,230	17,719,736	6,242,523	21,467,402	88,068,891
Liabilities	41,298,716	12,972,773	15,637,969	7,942,863	77,852,321
2018					
Assets	37,726,659	12,661,640	7,298,537	16,414,710	74,101,546
Liabilities	34,702,788	10,623,806	14,103,333	5,452,893	64,882,820

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Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

32 SEGMENTAL REPORTING (CONTINUED)

	Corporate banking AED'000	Commercial banking AED'000	Personal banking AED'000	Treasury & Investments AED'000	Total AED'000
2019					
Net interest income and net income from Islamic financing	769,171	543,677	442,725	210,009	1,965,582
Non-interest & other income	317,763	283,752	246,955	219,162	1,067,632
Total operating income	1,086,934	827,428	689,680	429,171	3,033,214
Expenses (note a)	228,976	234,029	419,517	2,648	885,170
Net provisions (note b)	323,471	322,384	94,942	7,057	747,854
	552,447	556,413	514,459	9,705	1,633,024
Net profit for the year	534,487	271,015	175,221	419,466	1,400,190
2018					
Net interest income and net income from Islamic financing	719,205	538,851	451,554	201,613	1,911,223
Non-interest & other income	225,485	247,814	183,257	156,924	813,480
Total operating income	944,690	786,665	634,811	358,537	2,724,703
Expenses (note a)	164,851	255,242	398,782	39,452	858,327
Net provisions (note b)	422,233	95,842	179,010	7,180	704,265
	587,084	351,084	577,792	46,632	1,562,592
Net profit for the year	357,606	435,581	57,019	311,905	1,162,111

(a) This includes staff and other expenses and depreciation and amortization.

(b) This includes impairment allowances on due from banks, loans and advances and Islamic financing, investment securities, and other assets, net of recoveries.

The following is an analysis of the total operating income of each segment between income from external parties and inter-segment:

	External parties		Inter-segment	
	2019 AED'000	2018 AED'000	2019 AED'000	2018 AED'000
Corporate banking	1,162,365	1,089,880	(75,431)	(145,190)
Commercial banking	998,555	886,555	(171,126)	(99,890)
Personal banking	520,238	525,111	169,442	109,700
Treasury & investments	352,056	223,157	77,115	135,380
Total operating income	3,033,214	2,724,703	-	-

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Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

33 RELATED PARTY TRANSACTIONS AND BALANCES

As at 31 December 2019 and 31 December 2018, Investment Corporation of Dubai (“ICD”) owned 20% share capital of the Bank. ICD is wholly owned by the Government of Dubai (the “Government”).

The Group in the ordinary course of business enters into transactions with major shareholders, directors, key management personnel and their related entities. The terms of these transactions are approved by the Group’s Board of Directors.

	Directors and key management personnel		Government related parties		Other related parties	
	2019 AED'000	2018 AED'000	2019 AED'000	2018 AED'000	2019 AED'000	2018 AED'000
Due from banks, net	-	-	284,690	-	-	-
Loans and advances and Islamic financing, net	171,238	416,198	859,201	1,262,582	1,905,663	1,398,356
Investment securities, net	-	-	1,013,706	1,315,852	-	-
Acceptances	-	-	-	-	2,201	12,715
Letters of credit	-	-	-	223	984	6,233
Letters of guarantee	-	-	212,975	323,525	109,428	226,869
Undrawn commitments to extend credit	24,188	28,424	412,047	529,246	298,546	463,374
Due to banks	-	-	-	180,170	-	-
Customer deposits and Islamic customer deposits	65,568	98,412	3,863,571	3,266,268	482,932	165,791
Interest income and commission income	9,767	20,927	43,105	80,916	80,527	71,927
Interest expense	818	719	98,142	90,965	7,095	1,807
Dividend from an associate	-	-	-	-	3,992	3,992

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Group, directly or indirectly, including any director (whether executive or otherwise) of the Group.

Other related parties represents major shareholders and parties related to directors, key management personnel.

The terms of transactions with related parties are comparable to third party transactions and do not involve more than normal amount of risk.

Sitting fees paid to directors for attending committee meetings during the year ended 31 December 2019 amounted to AED 4.3 million (2018: AED 3.1 million).

	2019 AED'000	2018 AED'000
Key management compensation		
Salaries	22,457	22,923
Post-employment benefits	898	998
Other benefits	22,201	17,793

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Notes to the consolidated financial statements (continued)

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34 RISK MANAGEMENT OBJECTIVES AND POLICIES

34.1 Risk Governance

The Board of Directors (the "Board") has the overall responsibility for the operations and the financial stability of the Group, and ensures that the interests of shareholders, depositors, creditors, employees and other stakeholders, including the banking regulators and supervisors, are addressed. The Board is responsible for strategic direction, management oversight and adequate control with the ultimate objective of promoting the success and long-term value of the Bank. The Board is also responsible for the overall framework of the risk governance, management, determining risk strategy, setting the Group's risk limits and ensuring that risk exposure is monitored, controlled effectively and kept within set limits. Additionally, it is responsible for establishing a clearly defined risk management structure and for approval of the risk policies and procedures as well as management of all risks related to the Group.

In order to effectively discharge this responsibility the Board is assisted by various Board Committees, namely Board Risk Committee (BRC), Audit & Compliance Committee (ACC), Credit & Investment Committee (CRIC), Financial Settlements and Recovery Committee (FSRC) and Nomination & Remuneration Committee (REMCO).

Management actively manages risk, primarily through the Risk Department with oversight by the Executive Committee (EXCO), Assets & Liabilities Committee (ALCO), Credit Committee (CC), Project Investment Committee (PIC), Information Security Risk Committee (ISRC), Compliance Committee (CCO), Human Resources Committee (HRC) and Operational Risk Management Committee (ORMC).

34.2 Control Environment

a) Group Risk

Group Risk Department comprises credit, market and operational units. Its responsibilities include the following:

- Developing a strategy, policy and framework for risk management such that these are aligned with business requirements;
- Providing support to the Group in implementation of the framework;
- Bringing together analysis of risk concentrations and sensitivities across the Group;
- Acting as a point of reference for risk and control matters, providing advice to management, sharing best practices and carrying out special reviews as directed by ALCO;
- Financial restructuring & recovery and business management and governance; and
- Providing independent assessment of, and challenge to the business areas' risk management and profiles to ensure that they are maintained in a robust manner.

b) Internal Audit

The role of the Internal Audit Department within the Group is to provide independent and objective assurance that the process for identifying, evaluating and managing significant risks faced by the Group is appropriate and effectively applied. In addition, it also provides an independent check on the compliance with laws and regulations and measuring compliance with the Group's policies and procedures. Additionally, Internal Audit provides consulting services which are advisory in nature, and are generally performed at the specific request of the ACC or Management.

It is led by the Chief Internal Audit Officer who reports to the ACC of the Board of Directors, with administrative reporting to the Chief Executive Officer of the Group.

To perform its role effectively, Internal Audit has organizational independence from management, to enable unrestricted evaluation of management activities and personnel. The Internal Audit Charter empowers it to have full, free and effective access at all reasonable times to all records, documents and employees of the Group. Internal Audit has direct access to the Chairman of the ACC and Chief Executive Officer of the Group.

To determine whether the Internal Audit Function is functioning effectively, the ACC shall:

- Assess the appropriateness of the Internal Audit Charter once each year;
- Assess the adequacy of resources available, both in terms of skills and funding once each year; and
- Sponsor external assessments, at least once every three (3) years, by a qualified, independent reviewer from outside the Group.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

34 RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

34.2 Control Environment (continued)

c) Internal Control

Board of Directors and Management are responsible for developing and maintaining the existence of a sound Internal Control System and procedures that meet international standards and fulfill the requirements of the Group's management and external regulatory bodies. The internal control system should be capable of ensuring the achievement of the following:

- Accuracy and integrity of financial and operational statements issued by the Group;
- Effectiveness and efficiency of the Group's operational activities;
- Effectiveness of measures and procedures set to safeguard the Group's assets and properties; and
- Compatibility with laws, legislations and regulations in force as well as policies pertinent to internal operational procedures.

Executive management constantly monitors and assesses the efficiency and effectiveness of internal control procedures and their ability to achieve stated objectives and their furtherance and enhancement.

The functions and responsibilities of the Internal Control Department include but not limited to:

- Ensuring that the Group's operational policies, processes and controls are adhered to;
- Ensuring that proper internal controls are in place and that they are functioning as designed in a timely and effective manner;
- Periodic review of the Group's internal control system in order to identify areas where internal controls may be weak, not present and areas where there appear to be excessive controls resulting in operational inefficiency so as to suggest ways to rectify the same;
- Enabling the management to conduct an annual review of the efficiency of the internal control system and report its findings; and
- Monitoring of operational activities and overseeing operational controls being exercised to ensure that these are timely and effective.

d) Compliance and Fraud prevention

The process of monitoring compliance is an independent task which aims at ensuring that the Group is in compliance with all applicable laws, regulations, instructions, directives, codes of conduct and sound banking standards and practices as issued by relevant authorities.

The Board of Directors takes necessary measures to further strengthen the values of integrity and sound professional conduct within the Group by promoting a culture of compliance in letter and spirit of applicable laws, regulations, instructions and standards.

The mission and role of compliance, AML and Fraud prevention department is to:

- Ensuring compliance risks are adequately identified, assessed, monitored and controlled in conjunction with Business and other control functions;
- Ensuring senior management is fully informed of significant compliance issues and plans for resolution;
- Contributing to a "no surprise" compliance culture by educating and communicating compliance awareness throughout the Group;
- Aligning annual compliance plans with business strategies and goals; and
- Meet regulatory expectations, Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) requirements.

Fraud prevention

The Group has a dedicated Fraud Prevention and Investigation Unit that assists in identification, detection, and verification of potential or actual fraud incidents including quantification and recoupment of any losses sustained as a result of such incident. The purpose is to manage susceptibility of Group's assets and processes to fraud risk with a view to reducing it and to raise the level of fraud awareness amongst employees and other stakeholders.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

34 RISK MANAGEMENT OBJECTIVES AND POLICIES (CONTINUED)

e) Whistle Blowing

A set of arrangements has been designed to enable employees to confidentially report concerns about any potential violations, enabling the investigation and follow up of such concerns independently and discreetly through the whistle blowing policy. Such arrangements are supervised by the ACC and in coordination with the executive management.

34.3 Disclosure policy

The Group has laid down the disclosure policy to ensure compliance with all regulations and guidelines issued by the lead regulator Central Bank of the UAE (CBUAE), International Financial Reporting Standards (IFRS), Securities and Commodities Authority (SCA) and Dubai Financial Market (DFM).

The following are the key features of the Group's disclosure policy concerning disclosure of financial information:

a) Materiality thresholds

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of consolidated financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement, and / or any material information that might affect the share price. The Group, in order to ensure adequate disclosure lays down qualitative materiality threshold, so that no material information is omitted or misstated; at the same time it does not jeopardize its competitive position.

b) Control framework

In order to ensure true and fair disclosure, the Group has established controls including detailed procedures for finalization and review of financial disclosures. In addition, the consolidated financial statements are subject to a quarterly review and year end audit procedures by the Group's external auditors.

c) Frequency and medium of disclosure

Interim financial results are disclosed on a quarterly basis while complete consolidated financial statements complying with the requirements of IFRS, Basel III Pillar 3, relevant laws of the U.A.E, SCA requirement and other guidelines from CBUAE is made on annual basis. Disclosures of material non-public financial information are made as follows:

- Uploading quarterly reviewed and annual audited consolidated financial statements along with Directors' report to DFM and SCA websites;
- Posting quarterly and annual consolidated financial statements on the Bank's website;
- Publishing of annual audited consolidated financial statements on the Bank's website;
- Management discussion and analysis in Arabic and English newspapers in a manner that ensures wide dissemination;
- Publication of the annual report which includes audited consolidated financial statements, list of names of members of the Board of Directors, senior executives, their deputies and assistants and names of wholly or partially owned subsidiaries; and
- Investor's pack is presented on Bank's website on a quarterly and annual basis.

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Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT

a) Introduction and overview

The Group has exposure to the following primary risks from financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk

Risk is inherent to the Group's business and activities. The Group's ability to identify, assess, monitor and manage each type of risk to which the Group is exposed is an important factor in its financial stability, performance and reputation.

The Group's risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Group, through its training, management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Board Risk Committee (BRC) is responsible for monitoring compliance with the Group's risk management policies and procedures, and for reviewing the adequacy of the risk management framework in relation to the risks faced by the Group. The Group's BRC is assisted in these functions by Internal Audit, which undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Group BRC as well as ACC.

This note presents information relating to the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital.

b) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations arising principally from the Group's balances with Central Bank, due from banks, loans and advances and Islamic financing, other financial assets, loan commitments and financial guarantee contracts. For reporting purpose, credit risk on loan commitments and financial guarantee contracts is reported as a component of credit risk on loans and advances and Islamic financing. For risk management purposes, credit risk arising on investment securities held at FVPL is managed independently.

(i) Management of credit risk

Credit Committee (CC) manages the credit risk of the Group by continuous review and update of the following:

- Formulating credit policies;
- Establishing the authorisation structure for the approval and renewal of credit facilities;
- Reviewing and assessing credit risk;
- Limiting concentrations of exposure to counterparties, geographies and industries;
- Developing and maintaining the Group's risk gradings;
- Developing and maintaining the Group's processes for measuring ECL;
- Reviewing compliance of business units with agreed exposure limits; and
- Providing advice, guidance and specialist skills to business units to promote best practice.

(ii) Internal credit risk ratings

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

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(ii) Internal credit risk ratings (continued)

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

- Payment record and ageing analysis;
- Extent of utilisation of granted limit;
- Forbearances (both requested and granted);
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies;
- For retail exposures: internally generated data of customer behaviour, affordability metrics etc.; and
- For corporate exposures: information obtained by periodic review of customer files including audited financial statements review and where available changes in the financial sector the customer operates etc.

The Group uses credit risk grades as a primary input into the determination of the term structure of the PD for exposures. The Group collects performance and default information about its credit risk exposures analysed by jurisdiction or region and by type of product and borrower as well as by credit risk grading.

The Group analyses all data collected using statistical models and estimates the remaining lifetime PD of exposures and how these are expected to change over time. The factors taken into account in this process include macro-economic data such as GDP growth, unemployment, benchmark interest rates and house prices. The Group generates a 'base case' scenario of the future direction of relevant economic variables as well as a representative range of other possible forecast scenarios. The Group then uses these forecasts, which are probability-weighted, to adjust its estimates of PDs.

The Group uses different criteria to determine whether credit risk has increased significantly for each obligor. The criteria used are both quantitative changes in PDs as well as qualitative.

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

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

Loss Given Default is the loss expected to arise on default, incorporating the impact of forward- looking economic assumptions where relevant, which represents the difference between the contractual cash flows due and those that the Bank expects to receive. The Bank estimates LGD based on history of recovery rates and considers the valuation of any collateral that is integral to the financial asset, taking into account forward-looking economic assumptions where relevant.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(iii) Measurement of ECL

As explained in note 3.1.1 (e), the Group measures ECL considering the risk of default over the maximum contractual period (including extension options) over which the entity is exposed to credit risk. However, for financial instruments such as credit cards and overdraft facilities that include both a loan and an undrawn commitment component, the Group's contractual ability to demand repayment and cancel the undrawn commitment does not limit the Group's exposure to credit losses to the contractual notice period. For such financial instruments the Group measures ECL over the period that it is exposed to credit risk and ECL would not be mitigated by credit risk management actions. These financial instruments do not have a fixed term or repayment structure and have a short contractual cancellation period. However, the Group does not enforce in the normal day-to-day management the contractual right to cancel these financial instruments. This is because these financial instruments are managed on a collective basis and are canceled only when the Group becomes aware of an increase in credit risk at the facility level. This longer period is estimated taking into account the credit risk management actions that the Group expects to take to mitigate ECL, e.g. reduction in limits or cancellation of the loan commitment. The maximum contractual period extends to the date at which the Group has the right to require repayment of an advance to terminate a loan commitment or guarantee.

(iv) Restructured and renegotiated loans

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

(v) Exposure to credit risk

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

2019	Stage 1	Stage 2	Stage 3	Total
	AED'000	AED'000	AED'000	AED'000
Due from banks				
Performing	2,430,868	-	-	2,430,868
Allowance for impairment losses	(3,133)	-	-	(3,133)
Net carrying amount	2,427,735	-	-	2,427,735
	Stage 1	Stage 2	Stage 3	Total
	AED'000	AED'000	AED'000	AED'000
Loans and advances				
Performing	52,348,762	7,198,430	-	59,547,192
Non-performing	-	-	4,492,069	4,492,069
Allowance for impairment losses	(517,614)	(609,152)	(2,731,685)	(3,858,451)
Net carrying amount	51,831,148	6,589,278	1,760,384	60,180,810

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Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(v) *Exposure to credit risk (continued)*

2018	Stage 1	Stage 2	Stage 3	Total
	AED'000	AED'000	AED'000	AED'000
Due from banks				
Performing	974,415	-	-	974,415
Allowance for impairment losses	(3,135)	-	-	(3,135)
Net carrying amount	971,280	-	-	971,280
	Stage 1	Stage 2	Stage 3	Total
	AED'000	AED'000	AED'000	AED'000
Loans and advances				
Performing	45,693,693	4,517,906	-	50,211,599
Non-performing	-	-	3,846,341	3,846,341
Allowance for impairment losses	(685,655)	(335,311)	(2,092,027)	(3,112,993)
Net carrying amount	45,008,038	4,182,595	1,754,314	50,944,947

The Group's Investment securities were classified under stage 1 at the reporting date (2018: classified under stage 1).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

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

The CBUAE has issued its IFRS 9 guidance addressing various implementation challenges and practical implications for Banks adopting IFRS 9 in the UAE ("the guidance").

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

	2019 AED'000	2018 AED'000
Allowances for impairment losses: General		
General provisions under Circular 28/2010 of CBUAE	1,006,311	874,263
Less: Stage 1 and Stage 2 provisions under IFRS 9	1,126,766	1,020,966
General provision transferred to the impairment reserve*	-	-
Allowances for impairment losses: Specific		
Specific provisions under Circular 28/2010 of CBUAE	2,515,321	2,084,734
Less: Stage 3 provisions under IFRS 9	2,731,685	2,092,027
Specific provision transferred to the impairment reserve*	-	-
Total provision transferred to the impairment reserve	-	-

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

(vii) Allowances for impairment

As discussed above in the significant increase in credit risk section, under the Group's monitoring procedures, a significant increase in credit risk is identified before the exposure has defaulted, and at the latest when the exposure becomes 30 days past due. This is the case mainly for loans and advances to customers and more specifically for retail lending exposures because for corporate lending and other exposures there is more borrower specific information available which is used to identify significant increase in credit risk. The table below provides an analysis of the gross carrying amount of loans and advances to customers by past due status.

Assets carried at fair value through profit or loss is not subject to ECL, as the measure of fair value reflects the credit quality of each asset.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(vii) Allowances for impairment (continued)

The Group monitors concentrations of its impaired loans by sector and by geographic location. An analysis of concentrations of impaired (excluding restructured / under restructuring) loans by sector is shown below:

	Impaired loans	Collateral	Specific provision and interest in suspense
2019	AED'000	AED'000	AED'000
Manufacturing	185,280	162,317	135,860
Construction	276,700	105,458	289,188
Real estate	739,602	698,719	331,816
Trade	435,454	277,953	371,292
Transportation and storage	41,317	25,887	29,362
Services	777,361	680,573	301,890
Hospitality	449,553	401,320	161,359
Financial and insurance activities	859,030	197,951	671,013
Personal - mortgage	307,229	139,236	200,231
Personal - schematic	211,104	97,918	125,158
Individual loans for business	209,332	121,082	114,410
Others	107	12	106
Total carrying amount	4,492,069	2,908,426	2,731,685
	Impaired loans	Collateral	Specific provision and interest in suspense
2018	AED'000	AED'000	AED'000
Manufacturing	173,215	87,048	117,628
Construction	218,897	43,580	219,611
Real estate	589,191	397,568	265,242
Trade	438,063	108,896	257,161
Transportation and storage	46,885	3,906	21,412
Services	71,789	14,138	41,330
Hospitality	433,478	420,066	40,758
Financial and insurance activities	1,067,582	341,346	561,683
Personal - mortgage	450,409	250,614	100,575
Personal - schematic	197,876	71,420	389,088
Individual loans for business	155,582	99,641	74,835
Others	3,374	-	2,704
Total carrying amount	3,846,341	1,838,223	2,092,027

All impaired loans are located in one geographic area i.e. the United Arab Emirates. The value of collateral is restricted to lower of loan exposure or realisable value of the collateral.

The gross carrying value of unfunded exposures pertaining to impaired loans amounted to AED 75.4 million (2018: AED 43.8 million).

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(viii) Write - off policy

The Group writes off a loan / investment in debt security (and any related expected credit allowances) when the Group Credit and Investment Committee (CRIC) determines that the loan / security is uncollectible. This determination is reached after considering information such as the significant deterioration in the borrower's / issuer's financial position such that the borrower / issuer can no longer pay the obligation, or proceeds from collateral will not be sufficient to pay back the entire exposure or all possible efforts of collecting the amounts have been

For smaller balances of standardized loans, write off decisions are generally based on a product-specific past due status.

(ix) Collateral

The Group holds collateral against loans and advances in the form of cash, guarantees, mortgages and liens over properties or other securities over assets. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and are subsequently monitored and updated on a periodic basis. Generally, collateral is not held against debt securities and amounts due from banks, and no such collateral was held at 31 December 2019 or 2018.

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

	2019	2018
	AED'000	AED'000
Pledged deposits	3,796,375	3,035,516
Properties	27,884,973	23,322,055
Mortgages	366,726	1,145,029
Pledge of shares	1,455,716	905,261
Bank guarantees	371,152	220,956
Gold	227,596	-
Credit Insurance	822,639	-
Others	54,818	72,029
Total collaterals	<u>34,979,996</u>	<u>28,700,846</u>

The above represents collateral value restricted to the lower of loan balance or collateral value.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(x) Concentration

Concentrations arise when a number of counterparties are engaged in similar business activities or activities in same geographic region or have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic, political or other conditions. The following tables set out the concentration of credit risk by sector, geography and currency.

Concentration of credit risk by sector for 2019:

	Loans and advances and Islamic financing	Due from banks	Debt securities	Equity securities and fund of funds	Cash, balances with Central bank and other assets	Total funded exposures	Undrawn commitments	Acceptances and contingent liabilities
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Manufacturing	2,432,279	-	352,116	-	-	2,784,395	584,084	908,324
Construction	4,383,388	-	-	-	-	4,383,388	1,124,968	6,603,348
Real estate	22,694,778	-	73,807	5,607	-	22,774,192	3,111,253	887,390
Trade	5,740,869	-	-	-	-	5,740,869	2,405,796	7,662,383
Transportation and storage	951,085	-	131,409	-	-	1,082,494	93,220	55,246
Services	5,714,626	-	366,082	43,179	-	6,123,887	1,153,252	1,249,216
Hospitality	2,574,068	-	-	169	-	2,574,237	267,412	7,788
Financial and insurance activities	8,184,858	2,430,868	2,446,443	253,861	85,127	13,401,157	1,441,310	1,365,654
Government entities	273,616	-	1,483,469	-	12,162,478	13,919,563	79,477	-
Personal - mortgage	3,307,884	-	-	-	-	3,307,884	26,556	-
Personal - schematic	4,690,832	-	-	-	-	4,690,832	2,830,978	30,134
Individual loans for business	1,759,653	-	-	-	-	1,759,653	488,981	2,517
Others	1,331,325	-	457,145	-	2,318,857	4,107,327	484,715	1,057,121
Total carrying amount	64,039,261	2,430,868	5,310,471	302,816	14,566,462	86,649,878	14,092,002	19,829,121

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(x) Concentration (continued)

Concentration of credit risk by sector for 2018:

	Loans and advances and Islamic financing	Due from banks	Debt securities	Equity securities and fund of funds	Cash, balances with Central bank and other assets	Total funded exposures	Undrawn commitments	Acceptances and contingent liabilities
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Manufacturing	2,359,918	-	135,108	-	-	2,495,026	444,412	854,621
Construction	3,677,834	-	-	-	-	3,677,834	680,359	4,880,963
Real estate	16,006,257	-	179,909	5,761	-	16,191,927	4,258,297	1,987,675
Trade	5,316,585	-	-	-	-	5,316,585	1,548,004	6,988,899
Transportation and storage	1,491,763	-	321,992	4,400	-	1,818,155	136,077	200,102
Services	4,305,056	-	616,113	53,780	-	4,974,949	957,111	852,334
Hospitality	2,652,430	-	-	-	-	2,652,430	392,691	13,324
Financial and insurance activities	7,311,952	974,415	3,054,990	18,157	84,842	11,444,356	1,434,320	903,656
Government entities	131,497	-	1,925,823	-	8,232,479	10,289,799	161,219	16
Personal - mortgage	2,835,784	-	-	-	-	2,835,784	42,716	-
Personal - schematic	4,924,986	-	-	-	-	4,924,986	2,436,157	22,429
Individual loans for business	2,032,242	-	-	-	-	2,032,242	534,086	3,592
Others	1,011,636	-	435,117	-	1,917,131	3,363,884	395,322	584,943
Total carrying amount	54,057,940	974,415	6,669,052	82,098	10,234,452	72,017,957	13,420,771	17,292,554

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(x) Concentration (continued)

Concentration of credit risk by geographic location for 2019:

	Loans and advances and Islamic financing AED'000	Due from banks AED'000	Debt securities AED'000	Equity securities and fund of funds AED'000	Cash, balances with Central bank and other assets AED'000	Total funded exposures AED'000	Undrawn commitments AED'000	Acceptances and contingent liabilities AED'000
UAE	59,632,846	181,632	3,191,424	48,786	14,566,462	77,621,150	13,662,093	16,375,608
GCC	195,072	377,521	1,027,617	-	-	1,600,210	11,006	165,890
Middle East	946,742	53,523	-	253,861	-	1,254,126	137,328	59,938
Europe	298,026	840,870	114,134	-	-	1,253,030	179,792	954,372
USA	1,243	680,034	363,851	169	-	1,045,297	1,109	421,544
Asia	1,288,488	183,724	546,494	-	-	2,018,706	54,533	1,837,375
Others	1,676,844	113,564	66,951	-	-	1,857,359	46,141	14,394
Total carrying amount	64,039,261	2,430,868	5,310,471	302,816	14,566,462	86,649,878	14,092,002	19,829,121

Concentration of credit risk by geographic location for 2018:

UAE	52,600,179	36,746	3,912,220	77,499	10,234,452	66,861,096	12,483,950	14,932,999
GCC	187,671	45,796	1,403,376	4,400	-	1,641,243	117,044	266,438
Middle East	305,022	108,498	-	-	-	413,520	420,403	105,305
Europe	194,606	370,318	243,552	199	-	808,675	87,581	722,060
USA	-	194,776	313,420	-	-	508,196	147	38,961
Asia	382,061	143,675	665,464	-	-	1,191,200	230,097	1,154,328
Others	388,401	74,606	131,020	-	-	594,027	81,549	72,463
Total carrying amount	54,057,940	974,415	6,669,052	82,098	10,234,452	72,017,957	13,420,771	17,292,554

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

b) Credit risk (continued)

(x) Concentration (continued)

Concentration of credit risk by currency for 2019:

	Loans and advances and Islamic financing AED'000	Due from banks AED'000	Debt securities AED'000	Equity securities and fund of funds AED'000	Cash, balances with Central bank and other assets AED'000	Total funded exposures AED'000	Undrawn commitments AED'000	Acceptances and contingent liabilities AED'000
AED	52,824,785	-	-	48,786	14,067,232	66,940,803	11,997,764	11,747,633
Other currencies*	11,214,476	2,430,868	5,310,471	254,030	499,230	19,709,075	2,094,238	8,081,488
Total carrying amount	64,039,261	2,430,868	5,310,471	302,816	14,566,462	86,649,878	14,092,002	19,829,121

Concentration of credit risk by currency for 2018:

AED	44,788,595	16	-	77,499	9,777,069	54,643,179	11,293,339	10,485,900
Other currencies*	9,269,345	974,399	6,669,052	4,599	457,383	17,374,778	2,127,432	6,806,654
Total carrying amount	54,057,940	974,415	6,669,052	82,098	10,234,452	72,017,957	13,420,771	17,292,554

*Majority of assets denominated in other currencies are in USD to which AED is pegged.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

c) Settlement risk

The Group's activities may give rise to risk at the time of settlement of transactions and trades. Settlement risk is the risk of loss due to the failure of counterparty to honour its obligations to deliver cash, securities or other assets as contractually due. Any delays in settlement are rare and are monitored and quantified as part of the Group's Internal Capital Adequacy Assessment Procedures (ICAAP) framework and Operational Risk Management.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement / clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval / limit monitoring process described above. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from the Group Risk Management Department.

d) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting its obligations associated with financial liabilities that are settled by delivering cash or other financial assets. It includes the risk of the inability to fund assets at contracted maturities and rates and the inability to liquidate assets at reasonable prices and in the required timeframe and the inability to meet obligations as they become due. Liquidity risk can be caused by market disruptions or credit downgrades which may cause certain sources of funding to diminish.

(i) Management of liquidity risk

Liquidity risk is managed by the Treasury and Asset and Liability management (ALM) department in line with the regulatory, internal policies and guidelines. The Group's approach to manage liquidity risk is to ensure that it has adequate funding from diversified sources at all times to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage of the Group's reputation.

Funds are raised using a broad range of instruments including customers' deposits, medium term borrowings, money market instruments, subordinated debts and capital. The treasury and ALM department monitors the liquidity profile of financial assets and liabilities and the projected cash flows arising from existing and future business. Treasury maintains a portfolio of short-term liquid assets and inter-bank placements to ensure that sufficient liquidity is maintained. The daily liquidity position is monitored and regular liquidity stress testing is conducted under a variety of scenarios covering both normal and abnormal market conditions.

The Group's liquidity management process, as carried out within the Group and monitored by Group's treasury, includes:

- Day to day funding is managed by monitoring future cash flows to ensure that requirements can be met - these include replenishment of funds as they mature or are borrowed by customers. The Group maintains an active presence in global money market to facilitate funding activities;
- Maintenance of a portfolio of highly marketable assets that can easily be liquidated as protection against any unforeseen interruption to cash flow;
- Managing balance sheet liquidity ratios against internal and regulatory requirements;
- Managing the concentration and profile of debt maturities; and
- Repurchase arrangements with various Banks which allow it to repo its fixed income investments to meet any liquidity needs that may arise.

(ii) Exposure to liquidity risk

The key measure used by the Group for measuring liquidity risk is the advances to stable resources ratio (regulatory ratio) which is 87.96% as at 31 December 2019 (2018: 89.42%). In addition, the Group also uses the following ratios / information on a continuous basis for measuring liquidity risk:

- Liquid assets to total assets ratio;
- Net loans to deposits ratio (LDR);
- Basel III ratios (including LCR, NSFR, etc.) are also monitored internally and shared with the Board on quarterly basis.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

d) Liquidity risk (continued)

The following table summarizes the maturity profile of the Group's assets and liabilities based on the contractual repayment arrangements. These do not take account of the effective maturities as indicated by the Group's deposit retention history. The contractual maturities of assets and liabilities have been determined on the basis of the residual period at the reporting date to the contractual maturity date.

The maturity profile of the assets and liabilities at 31 December 2019 was as follows:

	Total	Less than 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	No Fixed Maturity
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Assets							
Cash and balances with Central Bank	12,592,641	6,978,678	1,500,000	400,000	-	-	3,713,963
Due from banks, net	2,427,735	1,887,197	183,650	158,693	198,195	-	-
Loans and advances and Islamic financing, net	60,180,810	8,586,759	5,132,808	7,504,705	21,561,851	17,394,687	-
Investment securities	5,613,287	-	427,257	928,757	3,480,042	777,231	-
Investment in associate	85,127	-	-	-	-	-	85,127
Investment properties, net	198,896	-	-	-	-	-	198,896
Property and equipment	273,583	-	-	-	-	-	273,583
Bankers acceptances	5,346,819	3,965,387	652,685	728,747	-	-	-
Other assets, net	1,349,993	998,169	-	-	-	-	351,824
Total assets	88,068,891	22,416,190	7,896,400	9,720,902	25,240,088	18,171,918	4,623,393
Liabilities and equity							
Due to banks	4,166,589	1,197,484	76,196	383,650	2,509,259	-	-
Customer deposits and Islamic customer deposits	63,334,333	32,777,673	11,049,955	19,240,109	208,697	57,899	-
Notes and medium term borrowings	3,231,072	-	-	1,468,426	1,762,646	-	-
Due for trade acceptances	5,346,819	3,965,387	652,685	728,747	-	-	-
Other liabilities	1,773,508	1,728,395	-	-	-	-	45,113
Total liabilities	77,852,321	39,668,939	11,778,836	21,820,932	4,480,602	57,899	45,113
Gap representing equity	10,216,570	(17,252,749)	(3,882,436)	(12,100,030)	20,759,486	18,114,019	4,578,280

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

d) Liquidity risk (continued)

The maturity profile of the assets and liabilities at 31 December 2018 was as follows:

	Total	Less than 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years	No Fixed Maturity
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
Assets							
Cash and balances with Central Bank	8,682,322	3,132,048	600,000	1,300,000	-	-	3,650,274
Due from banks, net	971,280	664,825	18,925	182,245	105,285	-	-
Loans and advances and Islamic financing, net	50,944,947	7,411,686	4,515,856	7,275,231	19,780,583	11,961,591	-
Investment securities	6,751,150	-	23,793	952,836	4,622,677	1,069,746	82,098
Investment in associate	84,842	-	-	-	-	-	84,842
Investment properties, net	214,420	-	-	-	-	-	214,420
Property and equipment	343,093	-	-	-	-	-	343,093
Bankers acceptances	5,266,428	91,907	1,067,602	4,105,320	1,599	-	-
Other assets, net	843,064	732,268	-	-	-	-	110,796
Total assets	74,101,546	12,032,734	6,226,176	13,815,632	24,510,144	13,031,337	4,485,523
Liabilities and equity							
Due to banks	2,762,944	1,336,322	144,031	-	1,282,591	-	-
Customer deposits and Islamic customer deposits	53,165,030	27,130,021	8,861,068	16,559,281	614,124	536	-
Notes and medium term borrowings	2,609,944	-	-	-	2,609,944	-	-
Due for trade acceptances	5,266,428	91,907	1,067,602	4,105,320	1,599	-	-
Other liabilities	1,078,474	1,017,826	-	-	-	-	60,648
Total liabilities	64,882,820	29,576,076	10,072,701	20,664,601	4,508,258	536	60,648
Gap representing equity	9,218,726	(17,543,342)	(3,846,525)	(6,848,969)	20,001,886	13,030,801	4,424,875

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

d) Liquidity risk (continued)

The table below shows the maturity of the Group's contingent liabilities and credit commitments:

	Total	Less than 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years	Over 5 years
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
2019						
Contingent liabilities	14,482,302	4,204,585	6,046,658	4,024,726	176,026	30,307
Credit commitments	14,092,002	5,128,355	3,214,339	3,564,393	265,058	1,919,857
Total	28,574,304	9,332,940	9,260,997	7,589,119	441,084	1,950,164
2018						
Contingent liabilities	12,026,126	2,160,628	4,915,539	4,376,682	572,715	562
Credit commitments	13,420,771	2,635,300	3,024,248	3,785,944	714,896	3,260,383
Total	25,446,897	4,795,928	7,939,787	8,162,626	1,287,611	3,260,945

The tables below show undiscounted contractual cash flows on the Group's financial liabilities:

	Total	Less than 1 month	From 1 to 3 months	From 3 months to 1 year	From 1 to 5 years
	AED'000	AED'000	AED'000	AED'000	AED'000
2019					
Due to banks	4,448,598	1,180,036	103,265	487,177	2,678,120
Customer deposits and Islamic customer deposits	63,062,350	32,082,994	11,116,675	19,547,087	315,594
Notes and medium term borrowings	3,447,555	8,445	25,335	1,564,243	1,849,532
Due for trade acceptances	5,346,819	3,965,387	652,685	728,747	-
Other liabilities	580,708	580,708	-	-	-
Total liabilities	76,886,030	37,817,570	11,897,960	22,327,254	4,843,246
2018					
Due to banks	2,913,440	1,343,023	155,366	36,490	1,378,561
Customer deposits and Islamic customer deposits	53,852,867	27,208,072	8,984,915	17,009,999	649,881
Notes and medium term borrowings	3,000,053	3,866	3,129	20,986	2,972,072
Due for trade acceptances	5,266,428	91,907	1,067,602	4,105,320	1,599
Other liabilities	500,401	500,401	-	-	-
Total liabilities	65,533,189	29,147,269	10,211,012	21,172,795	5,002,113

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads, will affect the Group's income and / or value of a financial instrument. The Group manages its market risk in order to achieve optimum returns while maintaining market risk exposures within set risk appetite.

(i) Management of market risk

The Board of Directors sets the risk appetite pertaining to market Risk which translates into risk limits which are closely monitored by Group Risk Management, reported daily to senior management and discussed monthly by the ALCO.

The Group separates its exposure to market risk between trading and non-trading portfolios with overall responsibility vested with the ALCO. The Group Risk Management department is responsible for the development of detailed risk management policies and for the day-to-day implementation, subject to review and approval by the ALCO.

(ii) Exposure to interest rate risk – non trading portfolio

Interest rate risk arises from interest bearing financial instruments and reflects the possibility that changes in interest rates will adversely affect the value of the financial instruments and the related income. The Group manages the risk principally through monitoring interest rate gaps, matching the re-pricing profile of assets and liabilities and by having pre-approved limits for repricing bands. The Group Risk Management Department monitors compliance with these limits on a daily basis and is responsible for reporting breaches if any, to senior management. ALCO review reports on a monthly basis.

In addition the Group also assesses the impact of defined movement in interest yield curves on its net interest income and regulatory capital. The following is the impact of interest rate movement on net interest income and regulatory capital:

	2019		2018	
	50 b.p. AED'000	100 b.p. AED'000	50 b.p. AED'000	100 b.p. AED'000
Upward Parallel Shift	40,874	85,779	26,602	54,539
Downward Parallel Shift	(24,859)	(49,719)	(3,664)	(7,328)

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Market risk (continued)

A summary of the Group's interest rate sensitivity position based on contractual re-pricing arrangements or maturity dates, whichever dates are earlier is as follows:

	Non-interest bearing	Less than 3 months	From 3 to 6 months	From 6 months to 1 year	Over 1 Year	Total
	AED'000	AED'000	AED'000	AED'000	AED'000	AED'000
31 December 2019						
Assets						
Cash and balances with Central Bank	7,392,641	4,800,000	400,000	-	-	12,592,641
Due from banks, net	1,459,479	824,848	-	143,408	-	2,427,735
Loans and advances and Islamic financing	4,433,994	50,840,697	3,828,819	1,685,954	3,249,797	64,039,261
Expected credit losses	(3,858,451)	-	-	-	-	(3,858,451)
Investment securities	302,816	427,258	303,507	625,252	3,954,454	5,613,287
Investment in associate	85,127	-	-	-	-	85,127
Investment properties, net	198,896	-	-	-	-	198,896
Property and equipment	273,583	-	-	-	-	273,583
Bankers acceptances	5,346,819	-	-	-	-	5,346,819
Other assets, net	1,349,993	-	-	-	-	1,349,993
Total assets	16,984,897	56,892,803	4,532,326	2,454,614	7,204,251	88,068,891
Liabilities						
Due to banks	181,476	3,785,113	200,000	-	-	4,166,589
Customer deposits and Islamic customer deposits	20,698,320	23,129,308	9,878,999	9,361,111	266,595	63,334,333
Notes and medium term borrowings	-	1,138,236	624,410	1,468,426	-	3,231,072
Due for trade acceptances	5,346,819	-	-	-	-	5,346,819
Other liabilities	1,773,508	-	-	-	-	1,773,508
Total liabilities	28,000,123	28,052,657	10,703,409	10,829,537	266,595	77,852,321
Interest rate sensitivity gap	(11,015,226)	28,840,146	(6,171,083)	(8,374,923)	6,937,656	10,216,570
Cumulative interest rate sensitivity gap	(11,015,226)	17,824,920	11,653,837	3,278,914	10,216,570	
Represented by equity						10,216,570
31 December 2018						
Assets						
Cash and balances with Central Bank	4,382,322	3,000,000	500,000	800,000	-	8,682,322
Due from banks, net	628,095	36,730	90,231	216,224	-	971,280
Loans and advances and Islamic financing	3,651,186	39,923,389	2,548,605	1,612,403	6,322,357	54,057,940
Allowance for impairment losses	(3,112,993)	-	-	-	-	(3,112,993)
Investment securities	82,098	394,706	471,054	543,491	5,259,801	6,751,150
Investment in associate	84,842	-	-	-	-	84,842
Investment properties, net	214,420	-	-	-	-	214,420
Property and equipment	343,093	-	-	-	-	343,093
Bankers acceptances	5,266,428	-	-	-	-	5,266,428
Other assets, net	843,064	-	-	-	-	843,064
Total assets	12,382,555	43,354,825	3,609,890	3,172,118	11,582,158	74,101,546
Liabilities						
Due to banks	187,304	2,575,640	-	-	-	2,762,944
Customer deposits and Islamic customer deposits	16,819,512	19,171,577	9,464,268	7,095,013	614,660	53,165,030
Notes and medium term borrowings	-	1,143,241	-	-	1,466,703	2,609,944
Due for trade acceptances	5,266,428	-	-	-	-	5,266,428
Other liabilities	1,078,474	-	-	-	-	1,078,474
Total liabilities	23,351,718	22,890,458	9,464,268	7,095,013	2,081,363	64,882,820
Interest rate sensitivity gap	(10,969,163)	20,464,367	(5,854,378)	(3,922,895)	9,500,795	9,218,726
Cumulative interest rate sensitivity gap	(10,969,163)	9,495,204	3,640,826	(282,069)	9,218,726	
Represented by equity						9,218,726

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Notes to the consolidated financial statements (continued)

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35 FINANCIAL RISK MANAGEMENT (CONTINUED)

e) Market risk (continued)

Overall interest rate risk positions are managed by the Treasury and ALM Department, which uses investment securities, advances to banks, deposits from banks and derivative instruments to manage the overall position arising from the Group's activities. Interest rate risks are assumed by ALM from the businesses through fund transfer pricing process.

Currency risk

Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates and arises from financial instruments denominated in a foreign currency. The Board of Directors has set limits on positions by currency. Positions are closely monitored and hedging strategies are used to ensure positions are maintained within established limits. At 31 December, the Group had the following significant net exposures denominated in foreign currencies:

Currencies	Net spot	Forward	Net exposure	
	Position	Position	2019	2018
	←	AED'000	→	
US Dollar	1,790,260	(2,048,817)	(258,557)	825,805
GCC currencies	(2,644,266)	2,708,057	63,791	52,204
Great Britain Pound	(25,925)	25,864	(61)	231
Japanese Yen	18,868	(18,505)	363	150
Euro	9,664	(11,238)	(1,574)	1,476
Others	(6,320)	(854)	(7,174)	(2,863)

A summary of capital requirement for market risk under standardized approach of Basel III is set out below:

	2019	2018
	AED'000	AED'000
Foreign currency risk	910	2,269
Interest rate risk	48,446	42,449
	<u>49,356</u>	<u>44,718</u>

f) Equity risk

The Group has defined in its trading book policy the instruments which the Group is allowed to trade. A limited trading activity takes place in the equity market, monitored by Risk Management and in line with investment committee (IC) recommendations. Daily stop loss limits as well as portfolio notional limits are monitored daily and reported to senior management. In addition, the Group has classified an equity portfolio as FVOCI.

Analysis of equity portfolio:

	2019	2018
	AED'000	AED'000
Publicly traded (quoted):		
Equity (note 10)	48,786	72,324
Privately held (unquoted):		
Unquoted equity instruments and fund (note 10)	254,030	9,774
Total	<u>302,816</u>	<u>82,098</u>

Analysis of gains or (losses) on equity investments:

	2019	2018
	AED'000	AED'000
Realised gains on sale	3,730	1,384
Unrealised loss	(12,561)	(12,391)

Analysis of capital requirement for equity investments under standardized approach of Basel III:

	2019	2018
	FVOCI	FVOCI
	AED'000	AED'000
Equity	5,123	7,594
Unquoted equity instruments and fund	40,010	1,026
Total	<u>45,132</u>	<u>8,620</u>

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

35 FINANCIAL RISK MANAGEMENT (CONTINUED)

g) Operational risk

Operational risk is defined by Basel as “The risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, this includes legal risk but excludes strategic and reputation risks”.

The Group’s objective is to manage operational risk, so as to balance the avoidance of financial losses and damage to the Group’s reputation, with overall cost effectiveness and to avoid control procedures that restrict initiative, innovativeness and creativity.

The primary responsibility for the overseeing the establishment of sound operational risk management framework and monitoring the operational risk profile of the Group vests with the senior management of the Group, The Group has set up a cross functional committee named Operational Risk Management Committee (ORMC) of senior management personnel to formalize this responsibility and closely monitor key Operational Risks on a pan bank basis to support timely execution of action plans.

Accountability and responsibility is further assigned to the heads of individual units, departments or branches. This responsibility is supported by the development of overall Group standards for the management of operational risk in the following areas:

- Requirements for appropriate segregation of duties, including the independent authorisation of transactions to eliminate scenarios involving any conflict of interest;
- Requirements for the reconciliation and monitoring of transactions;
- Compliance with regulatory and other legal requirements;
- Documentation of controls and procedures pertaining to all activities of the bank;
- Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- Requirements for the reporting of operational losses and proposed remedial action to avoid its future recurrence;
- Development of contingency plans to ensure continuity of business under all circumstances;
- Training and professional development of employees at all levels so as to increase their awareness of the subject;
- Ethical and business standards (through the Group’s approved and functional Code of Ethics);
- Risk mitigation, including insurance wherever this is effective; and
- Whistle Blowing and Incident Reporting Policies are channels available to all staff for reporting of any loss events or other wrongdoings.

The Group has an approved framework for end-to-end management of its operational risks, which involves the active participation of the employees at all levels. The Operational Risk Management plan places an equal emphasis on the identification, assessment, control and reporting of operational risks and on quantification of potential risks and resultant losses therein, if any. Reports are produced covering Operational Risk dashboards, heat-maps, loss matrices, Operational Risk register and loss databases.

The Group has in place an operational risk management system to collate operational risk information in an automated environment; this has enabled the bank to build operational risk databases to support migration to more complex approaches for computation of operational risk capital in the future.

Group Risk Management continued its efforts towards increasing bank-wide awareness about the ORM concept, by organizing workshops, seminars and training courses on the subject, for the employees, throughout the year. On an ongoing basis, Risk and Control Self Assessments (RCSA) are being carried out by all branches and units to identify the operational risks and assess the effectiveness of existing controls, so as to plan any remedial actions (if required) and minimize recurrence of loss events.

Moreover, the Group conducts an assessment of disaster recovery and business continuity position, as well as detailed system risk assessments of all new / upgraded IT systems and assessment of Operational Risk elements in any new products to be launched or procedures to be implemented. Compliance with policies and procedures is supported by periodic reviews undertaken by Internal Audit. A review of the insurance coverage available to the Group is undertaken to maintain oversight of adequacy of insurance as necessitated by the Basel guidelines. Regular updates are provided to the senior management and the Board Risk Committee (BRC) to support their mandate to maintain adequate oversight of the Group’s operational risk framework and status of operational risks across all areas of the Group.

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Notes to the consolidated financial statements (continued)

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36 CAPITAL MANAGEMENT

36.1 Regulatory capital

The Group's regulator, the Central Bank of the UAE, sets and monitors regulatory capital requirements.

The Group's objectives when managing capital are as follows:

- Safeguard the Group's ability to continue as a going concern and optimize returns for shareholders;
- Comply with regulatory capital requirements set by the Central Bank of the UAE.

The Group's policy is to maintain a strong capital base so as to maintain investors, creditors and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also recognised and the Group recognises the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position.

The Group also assesses its capital requirements internally taking into consideration growth requirements and business plans, and quantifies its Regulatory and Risk / Economic Capital requirements within its integrated ICAAP Framework. Risks such as Interest Rate Risk in the Banking Book, Concentration Risk, Strategic Risk, Legal and Compliance Risk, Stress Risk, Insurance Risk and Reputational Risk are all part of the ICAAP.

The Group also calculates the Risk Adjusted Return on Capital (RAROC) for credit applications that are priced on a risk-adjusted basis. RAROC calculations are also built into the Credit Appraisal System.

The Central Bank of UAE ('CBUAE') supervises the Group on a consolidated basis, and therefore receives information on the capital adequacy of, and sets capital requirements for, the Group as a whole. Effective from 2017, the capital is computed at a Group level using the Basel III framework of the Basel Committee on Banking Supervision ('Basel Committee'), after applying the amendments advised by the CBUAE, within national discretion. The Basel III framework, like Basel II, is structured around three 'pillars': minimum capital requirements, supervisory review process and market discipline.

The Group's regulatory capital is analysed into two tiers:

- CET1 capital is the highest quality form of capital, comprising share capital, legal, statutory and other reserves, fair value reserve, retained earnings, after deductions for intangibles and other regulatory adjustments relating to items that are included in equity but are treated differently for capital adequacy purposes under 'CBUAE' guidelines.
- Tier 2 capital comprises of collective provision which shall not exceed 1.25% of total credit risk weighted assets.

The CBUAE issued Basel III capital regulations, which came into effect from 1 February 2017 introducing minimum capital requirements at three levels, namely Common Equity Tier 1 ('CET1'), Additional Tier 1 ('AT1') and Total Capital. The minimum capital adequacy requirements as set out by the Central Bank are as follows:

- Minimum common equity tier 1 (CET 1) ratio of 7% of risk weighted assets (RWAs).
- Minimum tier 1 ratio of 8.5% of RWAs.
- Total capital adequacy ratio of 10.5% of RWAs.

Additional capital buffers (Capital Conservation Buffer (CCB) and Countercyclical Capital Buffer (CCyB) - maximum up to 2.5% for each buffer) introduced over and above the minimum CET1 requirement of 7%.

The Group has complied with all the externally imposed capital requirements.

36.2 Capital resources and adequacy

The table below summarizes the composition of regulatory capital and the ratios of the Group as per BASEL III guidelines to which it is subject to:

	2019	2018
	AED'000	AED'000
Common equity tier 1 (CET1) capital		
Share capital	2,802,734	2,802,734
Legal and statutory reserve	1,401,367	1,401,367
General reserve	1,328,025	1,328,025
Retained earnings	4,006,186	3,193,854
Accumulated other comprehensive income	4,325	(138,543)
	9,542,637	8,587,437
Regulatory deductions and adjustments	(65,860)	(58,449)
Total CET1 capital	9,476,777	8,528,988
Tier 1 capital	9,476,777	8,528,988
Tier 2 capital		
Eligible general provision	838,593	728,552
Tier 2 capital	838,593	728,552
Total regulatory capital	10,315,370	9,257,540
Risk weighted assets (RWA)		
Credit risk	67,087,410	58,284,194
Market risk	470,053	425,881
Operational risk	5,241,559	4,893,229
Risk weighted assets	72,799,022	63,603,304
Tier 1 ratio	13.02%	13.41%
Tier 2 ratio	1.15%	1.15%
Capital adequacy ratio	14.17%	14.56%

Capital adequacy ratio calculation is after netting off proposed dividend distribution from capital base.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

36 CAPITAL MANAGEMENT (CONTINUED)

36.2 Capital resources and adequacy (continued)

Risk weighted capital requirement

The Group has adopted the standardized approach for credit risk and market risk and basic indicator approach for operational risk for regulatory reporting purposes. The Group's risk weighted capital requirement for credit, market and operational risk are given below:

(i) Risk weights for credit risk

The Group has a diversified funded and unfunded credit portfolio. The exposures are classified as per the Standard Portfolio approach mentioned under the Central Bank of UAE Basel III Capital Adequacy Framework covering the standardized approach for credit risk. The descriptions of the counterparty classes along with the risk weights used to derive the risk weighted assets are as follows:

• **Funded exposure**

Claims on sovereigns

These pertain to exposures to governments and their central banks. Claims on central banks and sovereigns are risk weighted in accordance with their ratings from acceptable external credit assessment institutions (ECAIs), except that, for all GCC sovereigns a 0% weight has been applied.

Claims on non-commercial public sector entities (PSEs)

Domestic currency claims on GCC non-commercial PSEs were treated as claims on GCC sovereigns if their Central Bank or monetary authority treats them as such. Foreign currency claims on GCC PSE were treated one grade less favourable than its sovereign i.e. 20% risk weights were applied. Claims on other foreign non-commercial PSEs were treated one grade less favourable than its sovereign.

Claims on multilateral development banks (MDBs)

All MDBs are risk weighted in accordance with each bank's credit rating except for those members listed in the World Bank Group which are risk weighted at 0%.

Claims on banks

Claims on banks are risk weighted based on the ratings assigned to them by external rating agencies, however, short term claims denominated in local currency were assigned more favourable risk weighting.

No claim on an unrated bank would receive a risk weight lower than that applied to claims on its sovereign of incorporation.

Claims on corporates and government related enterprises

Claims on corporate and government related entities (entities with greater than 50% government ownership) are risk weighted in accordance with ratings from acceptable ECAIs. Risk weight of 100% is applied on claims on unrated corporate and government related entities.

Claims on regulatory retail portfolio

Retail claims that are included in the regulatory retail portfolio are assigned risk weights of 75% (except for those assets that are past due loans), if they meet the criteria mentioned in the Central Bank of the UAE Basel III guidelines.

Claims secured by residential property

A preferential risk weight of 35% was applied on claims that did not exceed AED 10 million to a single borrower and the claim was secured by residential property with LTV of up to 85%. Other claims secured on residential property were risk weighted 100%.

Claims secured by commercial real estate

100% risk weight was applied on claims secured by commercial property.

Past due loans

The unsecured portion of any loan (other than a qualifying residential mortgage loan) that is past due for more than 90 days, net of specific provisions (including partial write-offs), is risk weighted as follows:

- 150% risk weight when specific provisions are less than 20% of the outstanding amount of loan;
- 100% risk weight when specific provisions are greater than 20% of the outstanding amount of loan.

All other assets are classified between 'assets under higher-risk categories' and 'others'; and risk weighted at the prescribed risk weights.

• **Unfunded exposure**

For credit-related contingent items, the nominal value is converted to an exposure through the application of Credit Conversions Factors (CCF). The CCF is at 20%, 50% or 100% depending on the type of contingent item, and is used to convert off balance sheet notional amounts into an equivalent on balance sheet exposure.

Undrawn commitments to extend credit represent commitments that have not been drawn down or utilized at the reporting date. The nominal amount provides the calculation base to which the CCF is applied for calculating the exposure. CCF range between 20% and 50% for commitment with original maturity of up to one year and over one year respectively and 0% CCF is applicable for commitments which can be unconditionally cancelled at any time.

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

36 CAPITAL MANAGEMENT (CONTINUED)

36.2 Capital resources and adequacy (continued)

(i) Risk weights for credit risk (continued)

Asset classes	On & off balance sheet	Credit risk mitigation (CRM)		On & off balance sheet	Risk weighted assets
	Gross outstanding	Exposure before CRM	CRM	Net exposure after credit conversion factors (CCF)	
2019	AED'000	AED'000	AED'000	AED'000	AED'000
Claims on sovereigns	14,135,328	14,135,328	-	14,134,980	339,731
Claims on non-commercial Public Sector Enterprises (PSEs)	116,469	116,469	-	116,469	-
Claims on multi lateral development banks	36,869	36,869	-	36,869	-
Claims on banks	9,007,339	9,007,339	811,161	7,775,305	4,285,176
Claims on corporates and government related enterprises	73,377,719	73,377,719	8,777,622	46,297,868	45,699,054
Claims included in the regulatory retail portfolio	4,477,711	4,477,711	55,594	3,221,379	2,588,499
Claims secured by residential property	2,714,186	2,714,186	5,281	2,682,739	969,584
Claims secured by commercial real estate	9,191,134	9,191,134	81,742	7,911,834	7,911,834
Past due loans	5,947,960	3,243,585	256,052	2,904,164	3,679,087
Higher-risk categories	28,995	28,995	-	28,995	43,493
Other assets	1,750,999	1,746,410	-	1,746,410	1,570,952
TOTAL CLAIMS	120,784,709	118,075,745	9,987,452	86,857,012	67,087,410
TOTAL CREDIT RISK					67,087,410
2018					
Claims on sovereigns	10,383,296	10,383,296	-	10,382,776	201,422
Claims on non-commercial Public Sector Enterprises (PSEs)	220,213	220,213	-	220,213	-
Claims on multi lateral development banks	-	-	-	-	-
Claims on banks	7,591,907	7,591,907	-	7,264,611	3,750,924
Claims on corporates and government related enterprises	61,797,891	61,794,816	8,315,663	38,446,271	37,702,934
Claims included in the regulatory retail portfolio	4,876,277	4,876,273	27,018	3,884,383	2,995,128
Claims secured by residential property	2,131,564	2,131,564	3,045	2,110,667	1,024,441
Claims secured by commercial real estate	9,236,518	9,236,518	210,081	7,754,982	7,754,982
Past due loans	5,182,795	3,093,849	31,859	2,982,811	3,688,647
Higher-risk categories	-	-	-	-	-
Other assets	1,479,957	1,468,261	-	1,468,261	1,165,717
TOTAL CLAIMS	102,900,418	100,796,697	8,587,666	74,514,974	58,284,194
TOTAL CREDIT RISK					58,284,194

Commercial Bank of Dubai PSC

Notes to the consolidated financial statements (continued)

For the year ended 31 December 2019

36 CAPITAL MANAGEMENT (CONTINUED)

36.2 Capital resources and adequacy (continued)

(i) Risk weights for credit risk (continued)

The Group uses the following external credit assessment institutions (ECAIs): Standard & Poor's, Moody's and Fitch. The external rating of ECAI is mapped to the prescribed credit quality assessment scale that in turn produces standard risk weightings. The Group also uses various CRM techniques. The total exposure to Banks before CRM includes AED 8,172 million (2018: AED 5,576 million) rated exposure.

Risk weighted assets as per standardized approach is set out below:

	2019		2018	
	Exposure	Risk weighted assets	Exposure	Risk weighted assets
	AED'000	AED'000	AED'000	AED'000
Exposure prior to CRM	96,844,464	76,991,738	83,102,640	66,877,912
Less: Eligible financial collateral	9,987,452	9,904,328	8,587,666	8,593,718
Net exposure after CRM	<u>86,857,012</u>	<u>67,087,410</u>	<u>74,514,974</u>	<u>58,284,194</u>

(ii) Risk weights for market risk

Capital requirement for market risk is calculated using standardized approach. The capital requirement for market risk is analysed into capital requirement for interest rate risk, equity risk, foreign exchange risk and option risk.

(iii) Risk weight for operation risk

Capital requirement for operation risk is calculated using basic indicator approach. This capital charge was computed using basic indicator approach by multiplying the three years average gross income by a predefined beta factor.

37 COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in these consolidated financial statements, the effect of which are considered immaterial.