

Financial Statements of

BAC BAHAMAS BANK LIMITED

Year ended December 31, 2016

BAC BAHAMAS BANK LIMITED

Financial Statements

Year ended December 31, 2016

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INDEPENDENT AUDITORS' REPORT

To the Shareholder of BAC Bahamas Bank Limited

Opinion

We have audited the financial statements of BAC Bahamas Bank Limited (the "Bank"), which comprise the statement of financial position as at December 31, 2016, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 2016, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

Emphasis of Matter

We draw attention to notes 1 and 6 of the financial statements. The Bank's operations include extensive transactions and balances with related parties. Our opinion is not modified in respect of this matter.

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

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

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

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



Auditors' Responsibilities for the Audit of the Financial Statements

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

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

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

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

April 28, 2017

BAC BAHAMAS BANK LIMITED

Statement of Financial Position

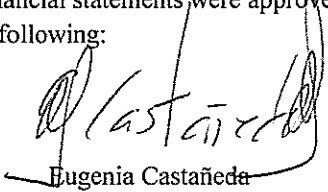
December 31, 2016, with corresponding figures for 2015

(Expressed in United States dollars)

	2016	2015
ASSETS		
Cash and cash equivalents (notes 6 and 7)	\$ 68,000,285	56,086,814
Loans to customers, net (notes 6 and 8)	14,351,502	398,800
Accrued interest receivable (note 6)	35,584	542
Furniture and equipment	6,445	9,344
Other receivables and assets	31,736	26,436
Total assets	\$ 82,425,552	56,521,936
LIABILITIES AND EQUITY		
Liabilities:		
Demand deposits from customers (notes 6 and 9)	\$ 33,416,267	13,997,495
Time deposits from customers (notes 6 and 10)	25,582,419	19,933,962
Accrued interest payable (note 6)	115,957	153,004
Other liabilities (note 6)	113,165	48,968
	59,227,808	34,133,429
Equity:		
Share capital (note 11)	18,000,000	18,000,000
Reserve for losses on loans (note 15)	308,812	5,988
Retained earnings	4,888,932	4,382,519
	23,197,744	22,388,507
Total liabilities and equity	\$ 82,425,552	56,521,936

The accompanying notes are an integral part of these financial statements.

The financial statements were approved on behalf of the Board of Directors on April 28, 2017
by the following:


Eugenia Castañeda
Director


Daniel Pérez
Director

BAC BAHAMAS BANK LIMITED

Statement of Comprehensive Income

Year ended December 31, 2016, with corresponding figures for 2015

(Expressed in United States dollars)

	2016	2015
Net interest income:		
Interest income on cash and cash equivalents (note 6)	\$ 2,079,007	1,590,354
Interest income on loans (note 6)	426,922	21,393
Interest expense (note 6)	(900,267)	(755,014)
Net interest income	1,605,662	856,733
Net commission income:		
Commission income	12,205	11,041
Commission expense	(11,158)	(10,320)
Net commission income	1,047	721
Other operating income (expense):		
Other income (note 6)	63,189	45,099
General and administrative (notes 6 and 13)	(833,409)	(783,626)
(Provision for) reversal of loan losses (note 8)	(27,252)	134
	(797,472)	(738,393)
Net income and total comprehensive income for the year	\$ 809,237	119,061

The accompanying notes are an integral part of these financial statements.

BAC BAHAMAS BANK LIMITED

Statement of Changes in Equity

Year ended December 31, 2016, with corresponding figures for 2015

(Expressed in United States dollars)

	Number of shares	Share capital	Reserve for losses on loans	Retained earnings	Total
Balance at December 31, 2014	18,000,000	\$ 18,000,000	6,564	4,262,882	22,269,446
Net income and total comprehensive income for the year	0	0	0	119,061	119,061
Transfer to retained earnings (note 15)	0	0	(576)	576	0
Balance at December 31, 2015	18,000,000	18,000,000	5,988	4,382,519	22,388,507
Net income and total comprehensive income for the year	0	0	0	809,237	809,237
Transfer from retained earnings to reserve for loans losses (note 15)	0	0	302,824	(302,824)	0
Balance at December 31, 2016	18,000,000	\$ 18,000,000	308,812	4,888,932	23,197,744

The accompanying notes are an integral part of these financial statements.

BAC BAHAMAS BANK LIMITED

Statement of Cash Flows

Year ended December 31, 2016 with corresponding figures for 2015
(Expressed in United States dollars)

	2016	2015
Cash flows from operating activities:		
Net income	\$ 809,237	119,061
Adjustments for:		
Provision (reversal) for loan losses	27,252	(134)
Depreciation	2,899	2,938
Net interest income	(1,605,662)	(856,733)
	(766,274)	(734,868)
Changes in operating assets and liabilities:		
Loans to customers	(13,979,954)	362,049
Other receivables and assets	(5,300)	19,042
Demand deposits	19,418,772	2,592,759
Time deposits	5,648,457	(1,703,066)
Other liabilities	64,197	28,081
	10,379,898	563,997
Interest received	2,470,887	1,612,293
Interest paid	(937,314)	(754,966)
Net cash provided by operating activities	11,913,471	1,421,324
Cash flows from investing activities		
Purchase of furniture and equipment	0	(1,984)
Net cash used in investing activities	0	(1,984)
Increase in cash and cash equivalents during the year	11,913,471	1,419,340
Cash and cash equivalents at beginning of year	56,086,814	54,667,474
Cash and cash equivalents at end of year	\$ 68,000,285	56,086,814

The accompanying notes are an integral part of these financial statements.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements

Year ended December 31, 2016
(Expressed in United States dollars)

1. Reporting entity

BAC Bahamas Bank Limited (“the Bank”) was incorporated under the laws of The Commonwealth of The Bahamas on August 13, 1992 and was granted a banking license on March 16, 1992 by The Central Bank of The Bahamas. The Bank’s registered office is located at Norfolk House, Frederick Streets, Nassau, Bahamas.

The Bank is a wholly owned subsidiary of BAC International Bank, Inc. (the Parent Company), a bank incorporated in the Republic of Panama. The Parent Company is ultimately owned by Grupo Aval Acciones y Valores S.A., a company incorporated in Colombia.

The Bank is primarily involved in corporate and investment banking.

A substantial portion of the Bank’s business is with the related parties. A significant amount of the Bank’s cash and cash equivalents are held with related parties and the Bank’s revenue is primarily from the interest income on such cash and cash equivalents (See note 6). Accordingly, the Bank is economically dependent on these related parties and is exposed to a significant credit risk in respect of the related parties’ balances at the reporting date.

2. Basis of preparation

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB).

(b) Basis of measurement

The financial statements have been prepared on the historical cost basis.

The Bank initially recognizes loans, accounts receivable and deposits on the date on which they are originated. All other financial instruments are recognized on the trade date, which is the date on which the Bank becomes a party to the contractual provisions of the instrument.

(c) Functional and presentation currency

These financial statements are presented in United States dollars (\$), which is also the Bank’s functional currency.

(d) Use of estimates and judgments

Preparation of financial statements requires the Bank’s management to make judgments, estimates and assumptions affecting the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Final results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized prospectively.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

2. Basis of preparation, continued

Information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are disclosed in the following notes:

- Fair value measurement (note 3(d)(iv) and 14)
- Impairment (note 3(d)(vii), 3(h) and 5)
- Allowance for loan losses (note 3(f) and 5)

3. Significant accounting policies

The accounting policies explained below have been applied consistently to all periods presented in these financial statements.

(a) Foreign currency

Assets and liabilities in foreign currencies are translated at prevailing exchange rates at the reporting date. Transactions in foreign currencies during the year are translated at exchange rates in effect on the date of the transaction. Differences arising from such translations are presented as other operating income or other expenses in the statement of comprehensive income.

(b) Interest

Interest income and expense are recognized as part of profit or loss in the statement of comprehensive income using the effective interest rate method. This method uses a rate that discounts the estimated future cash receipts and payments through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. The effective interest rate is established on initial recognition of the financial asset and liability and is not revised subsequently.

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

Interest income and expense presented in the statement of comprehensive income include:

- interest on financial assets and liabilities at amortized cost on an effective interest rate method.
- interest income on available-for-sale investments.

(c) Fees and commission

Fees and commission income that are integral to the effective interest rate of a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including service commissions are recognized as the related services are provided.

Deferred loan fees, if any, are amortized over the period of the loan using the effective interest rate method.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(d) Financial instruments

(i) Classification

Financial instruments include financial assets and financial liabilities.

In classifying financial assets in each of the categories described below, the Bank has determined that it meets the description or criteria set out in the accounting policies.

The Bank has not designated any financial instruments as “fair value through profit or loss”.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Bank has classified loans to customers, accrued interest receivable and other receivables as loans and receivables.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Bank has the positive intent and ability to hold to maturity, and which are not designated as at fair value through profit or loss or as available-for-sale. The Bank has not classified any financial assets as “Held-to-maturity”.

Available-for-sale investments are those non-derivative financial assets that have not been classified as loans and receivables, held-to-maturity assets or financial assets at fair value through profit or loss. At the reporting date, the Bank did not have any available-for-sale investments.

The Bank considers due from banks with original maturities of three months or less that are subject to insignificant risks of changes in their fair value and are used by the Bank in the management of its short-term commitments, to be cash and cash equivalents.

Financial liabilities include demand and time deposits from customers, accrued interest payable and other liabilities.

(ii) Recognition

The Bank initially recognizes loans to customers and demand and time deposits from customers, on the date that they are originated. All other financial assets and liabilities are initially recognized on the trade date which is when the Bank becomes a party to the contractual provisions of the instrument.

(iii) Measurement

Financial instruments are measured initially at fair value plus, in the case of financial assets or financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability. Transaction costs on financial assets and financial liabilities at fair value through profit or loss and available-for-sale investments are expensed immediately, while on other financial instruments they are amortized.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(d) *Financial instruments, continued*

(iii) *Measurement, continued*

Subsequent to initial recognition, financial assets classified as loans and receivables are carried at amortized cost using the effective interest rate method, less impairment losses, if any. Financial liabilities are carried at amortized cost.

Subsequent to initial recognition, available-for-sale investments are carried at fair value and changes in the fair value, other than impairment losses are recognized in other comprehensive income and presented in the fair value reserve in equity, until an asset is considered to be impaired, at which time the loss is recognized in profit or loss in the statement of comprehensive income. When the asset is sold, collected, or otherwise disposed of, the cumulative gain or loss recognized in the statement of changes in equity is recorded in profit or loss in the statement of comprehensive income.

(iv) *Fair value measurement*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When applicable, the Bank measures the fair value of an instrument using the quoted price in an active market for that instrument. A market is regarded as active if transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis. When there is no quoted price in an active market, the Bank uses valuation techniques that maximize the use of relevant observable inputs and minimize the use of unobservable inputs. The chosen valuation technique incorporates all the factors that market participants would take into account in pricing a transaction.

The best evidence of the fair value of a financial instrument at initial recognition is normally the transaction price – i.e. the fair value of the consideration given or received. If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is evidenced neither by a quoted price in an active market for an identical asset or liability nor based on a valuation technique that uses only data from observable markets, the financial instrument is initially measured at fair value, adjusted to defer the difference between the fair value at initial recognition and the transaction price.

Subsequently, that difference is recognized in profit or loss on an appropriate basis over the life of the instrument but no later than when the valuation is supported wholly by observable market data or transaction is closed out.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(d) Financial instruments, continued

(v) Derecognition

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows from the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Bank is recognized as a separate asset or liability.

The Bank derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

Transactions whereby the Bank transfers assets recognized on its statement of financial position, but retains either significantly all risks and rewards of the transferred assets or a portion of them are not derecognized from the statement of financial position.

The Bank also derecognizes certain assets when it charges off balances pertaining to the assets deemed to be uncollectible.

(vi) Offsetting

Financial assets and liabilities are set off and the net amount is presented in the statement of financial position when, and only when, the Bank has a legal right to set off the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously. Income and expenses are presented on a net basis only when permitted by IFRS or for gains and losses arising from similar transactions.

(vii) Identification and measurement of impairment

At each reporting date, the Bank assesses whether there is objective evidence that financial assets are impaired. Financial assets are impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset, and that the loss event has an impact on the future cash flows on the asset that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the absence of an active market for a security, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers, or economic conditions that correlate with defaults in the Bank.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(d) *Financial instruments, continued*

(vii) *Identification and measurement of impairment, continued*

The Bank considers evidence of impairment at both a specific asset and collective level. All individually significant financial assets are assessed for specific impairment. All significant assets found not to be specifically impaired are then collectively assessed for any impairment that has been incurred but not yet identified. Assets that are not individually significant are then collectively assessed for impairment by grouping together financial assets (carried at amortized cost) with similar risk characteristics.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial assets and the present value of estimated cash flows discounted at the assets' original effective interest rates. Impairment losses are recognized in the statement of comprehensive income and reflected in an allowance account against loans to customers. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount on an impairment loss to decrease, the impairment loss is reversed through the statement of comprehensive income.

(e) *Cash and cash equivalents*

Cash and cash equivalents include notes and coins on hand, unrestricted balances with banks and highly liquid financial assets, which are subject to insignificant risk of changes in their fair value, and used by the Bank in the management of its short-term commitments.

Cash and cash equivalents are carried at amortized cost in the statement of financial position.

(f) *Loans receivable*

As described in note 3(d)(i), loans receivable are non-derivative financial assets with fixed or determinable payments that are not quote in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans receivable are stated at their outstanding unpaid principal balances adjusted for unearned income, when applicable, and are presented net of specific and general allowances for collectability.

Carrying amount of loans that are identified as being impaired are reviewed on a regular basis to reduce these loans to their recoverable amounts. General allowances are maintained to reduce the carrying amount of portfolios of similar loans to their estimated recoverable amounts at the reporting date. The expected cash flows for portfolios of similar assets are estimated based on a previous experience and considering the credit rating of the underlying customers and late payments of interest or penalties. Increases in the allowance account are recognized in the statement of comprehensive income. Once a loan is determined to be uncollectible, all necessary legal procedures have been completed, and the final loss has been quantified, the loan is written off.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(g) Furniture and equipment

Furniture and equipment are stated at cost less accumulated depreciation and impairment losses, if any.

Depreciation is recognized in the statement of comprehensive income on a straight-line basis over the estimated useful lives of each part of an item of furniture and equipment.

The estimated useful lives for the current and corresponding periods are as follows:

- Equipment 3 - 5 years
- Fixtures and fittings 5 - 10 years

Depreciation methods and useful lives are reassessed at the reporting date.

Expenditure for maintenance and repairs are charged against income. At the time of disposal or retirement of assets, the cost and related accumulated depreciation are eliminated, and any resulting profit or loss is reflected in the statement of comprehensive income.

(h) Impairment of non-financial assets

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

The recoverable amount of an asset is the greater of its value in use and its fair value less costs to sell. 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.

An impairment loss is recognized if the carrying amount of an asset exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of comprehensive income.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

(i) Related parties

- (a) A person or a close member of that person's family is related to the Bank if that person:
 - (i) has control or joint control over the Bank;
 - (ii) has significant influence over the Bank; or
 - (iii) is a member of the key management personal of the Bank or of a parent of the Bank.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

3. Significant accounting policies, continued

(i) Related parties, continued

(b) An entity is related to the Bank if any of the following conditions applies:

- (i) The entity and the Bank 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 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 associate of the third entity.
- (v) The entity is a post-employment benefit plan for the benefit of employees of either the Bank or an entity related to the Bank.
- (vi) The entity is controlled or jointly controlled by a person identified in (i)(a).
- (vii) 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) A related party transaction is a transfer of resources, services or obligations between the Bank and related party, regardless of whether a price is charged.

(j) New standards and interpretations not yet adopted

There are a number of standards and interpretations which were not effective as of the reporting date and have not been adopted in preparing of these financial statements. The most significant ones which may impact the Bank's financial statements are described below:

- The final version of IFRS 9 "Financial Instruments" (2014) supersedes any previous versions of IFRS 9 (2009, 2010 and 2013) and completes the project to supersede IAS 39. IFRS 9 is effective for January 1, 2018. The most important effects of this Standard include:
 - New requirements for the classification and measurement of financial assets. This standard contains, among other aspects, two primary categories to measure financial assets: amortized cost and fair value. IFRS 9 eliminates existing categories in IAS 39 of held-to-maturity securities, available for sale securities, loans and accounts receivable.
 - It eliminates volatility in results caused by changes in the credit risk of liabilities measured at fair value, which implies that gains obtained from the entity's own credit risk impairment on this type of obligation, is no longer recognized in the results of the period, but in equity.
 - A substantially amended approach for hedge accounting, with improved disclosures on the risk management activity.
 - A new impairment model, based on "expected loss" that will require a greater and more timely recognition of expected lending losses.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

3. Significant accounting policies, continued

(j) *New standards and interpretations not yet adopted, continued*

- IFRS 15 “Revenue from Contracts with Customers”. This Standard establishes a single comprehensive framework to determine how, how much and when revenue should be recognized. This Standard replaces existing guidelines, including IAS 18 “Revenues from Ordinary Activities”, IAS 11 “Construction Contracts”, and IFRIC 13 “Customer Loyalty Programs”. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, and early adoption is permitted.
- IFRS 16 “Leases”, was issued to replace IAS 17 “Leases”. IFRS 16 eliminates classification of leases either as operating leases or finance leases for the lessee. Instead, all leases are recognized similarly to finance leases under IAS 17. Leases are measured at the present value of future lease payments and are presented as either leased assets (right of use assets) or along with property, furniture and equipment. IFRS 16 is effective for annual periods beginning on or after January 1, 2019.

Management is in process of evaluating the possible impact of the application of these standards on the Bank’s financial statements.

4. Financial risk management

(a) *Introduction and overview*

The Bank has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- market risk
- operational risk

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

Risk management framework

The Board of Directors has overall responsibility for the establishment and oversight of the Bank’s risk management framework. The Board has established the Asset and Liability Committee (“ALCO”), Credit and Operational Risk committees, which are responsible for developing and monitoring risk management policies in their specified areas. All committees have both executive and non-executive members and report regularly to the Board of Directors on their activities.

The Bank’s risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to regulatory and internal limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank aims to develop a disciplined and constructive control environment through trainings, established procedures, and manuals, in which all employees understand their roles and responsibilities.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

4. Financial risk management continued

(a) Introduction and overview, continued

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

This following section provides information of the Bank's exposure to risk and describes the methods used by management to control risks. The most significant types of financial risk to which the Bank is exposed are credit, liquidity, and price risk. Market risk includes currency risk, interest rate risk and price risk.

(b) Credit risk

Management of credit risk

Credit risk is the risk of financial loss to the Bank if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Bank's loans and advances to customers and other banks and investments. For risk management reporting purposes, the Bank considers and consolidates all elements of credit risk exposure (such as individual obligor default risk, country and sector risk). For risk management purposes, credit risk arising on investments is managed independently, but reported as a component of market risk exposure.

The Bank's maximum credit risk exposure is shown below:

	2016	2015
Cash and cash equivalents	\$ 68,000,285	56,086,814
Loans to customers, net	14,351,502	398,800
Accrued interest receivable	35,584	542
Other receivables and assets	31,736	26,436
	<u>\$ 82,419,107</u>	<u>56,512,592</u>

The Board of Directors has delegated responsibility for the management of credit risk to the Parent Company's Credit Committee. A separate credit department, reporting to the Credit Committee, is responsible for oversight of the Bank's credit risk, including:

- Formulating credit policies in consultation with business units, covering collateral requirements, credit assessment, risk grading and reporting, documentary and legal procedures, and compliance with regulatory and statutory requirements.
- Establishing the authorization structure for the approval and renewal of credit facilities. Authorization limits are allocated to business unit Credit Officers.

Larger facilities require approval by the Head of the Credit Committee or the Board of Directors, as appropriate.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(b) Credit risk, continued

- Reviewing and assessing credit risk. The Credit Committee assesses all credit exposures in excess of designated limits, prior to facilities being committed to customers by the business unit concerned. Renewals and reviews of facilities are subject to the same review process.
- Limiting concentrations of exposure to counterparties, geographic areas and industries (for loans to customers).
- Developing and maintaining the Bank's risk grading system in order to categorize exposures according to the degree of risk of financial loss faced and to focus management on the attendant risks. The risk grading system is used in determining where impairment provisions may be required against specific credit exposures. The current risk grading framework consists of nine grades reflecting varying degrees of risk of default and the availability of collateral or other credit risk mitigation. The responsibility for setting risk grades lies with the final approving executive/committee as appropriate. Risk grades are subject to regular reviews.
- Reviewing compliance of business units with agreed exposure limits, including those for selected industries, country risk and product types. Regular reports are provided to the Credit Committee on the credit quality of local portfolios and appropriate corrective action is taken.
- Providing advice, guidance and specialist skills to business units to promote best practice throughout the Bank management of credit risk.
- Each business unit is required to implement credit policies and procedures, with credit approval authorities from the Credit Committee. Each business unit has a Chief Credit Risk officer who reports on all credit related matters to local management and the Credit Committee. Each business unit is responsible for the quality and performance of its credit portfolio and for monitoring and controlling all credit risk in its portfolios, including those subjects to central approval. Regular audits of business units and credit processes are undertaken by the Parent Company's Internal Audit department.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(b) Credit risk, continued

Exposure to credit risk of loans to customers is shown below.

	2016	2015
Grade 1 Low Risk	0	0
Grade 2 Fair Risk	5,000,000	0
Grade 3 Fair Risk	5,057,599	399,721
Grade 4 Average Risk	4,322,076	0
Grade 5 Watch List	0	0
Grade 6 Marginal	0	0
Grade 7 Substandard	0	0
Grade 8 Doubtful	0	0
Grade 9 Impaired	0	0
Gross amount	14,379,675	399,721
Allowance for impairment	(28,173)	(921)
Total carrying amount	\$ 14,351,502	398,800

Allowances for impairment

The Bank establishes an allowance for impairment losses that represents its estimate of incurred losses in its loan portfolio. The main components of this allowance are a specific loss component that relates to individually significant exposures, and a collective loan loss allowance established for groups of homogeneous assets in respect of losses that have been incurred but have not been identified on loans not subject to individual assessment for impairment.

Impaired loans

Impaired loans are loans for which the Bank determines that it is probable that it will be unable to collect all principal and interest due according to the contractual terms of the loans agreements. These loans are graded 7 to 9 in the Bank's internal credit risk grading system. At December 2016 and 2015, there are no grade 7 to 9 loans.

Loans with renegotiated terms

Loans with renegotiated terms are loans that have been restructured due to deterioration in the borrower's financial position and where the Bank has made concessions that it would not otherwise consider. Once the loan is restructured it remains in this category independent of satisfactory performance after restructuring. At December 2016 and 2015, there are no loans with renegotiated terms.

Write-off policy

The Bank writes off a loan (and any related allowances for impairment losses) when the Credit Committee determines that the carrying value of the loan is not recoverable. This determination is reached after considering information such as the occurrence of significant changes in the borrower financial position such that the borrower can no longer meet the obligation, or that proceeds from collateral will not be sufficient to pay back the entire exposure. For smaller balance standardized loans, charge off decisions generally are based on a product specific past due status.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(b) Credit risk, continued

Collateral

The Bank holds collateral in respect of loans and advances in the form of cash mortgages over property, chattel mortgages and other guarantees. Estimates of fair value are based on the value of collateral assessed at the time of borrowing, and generally are not updated except when a loan is individually assessed as impaired. At December 31, 2016, an estimate of the fair value of collateral held for mortgages and chattel mortgages in respect of financial assets was \$4,322,076 (2015: \$357,670).

Concentration of credit risk

The Bank monitors concentration of credit risk by geographic location. As of December 31, 2016, there was concentration of credit risk in respect of loans to customers in Panama amounting to \$14,351,502 (2015: \$398,800). Concentration by location of loans to customers is measured based on the location of the costumers holding the asset, which has a high correlation with the location of the borrower.

As of December 31, 2016, there was concentration of credit risk in respect of cash and cash equivalents with related parties amounting to \$64,388,310 (2015: \$40,161,779). The credit risk exposure arising from these balances held with related parties is managed at the group level.

Settlement risk

The Bank'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 a borrower to honor its obligations to deliver cash, securities or other assets as contractually agreed. For certain types of transactions, the Bank 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 earlier. Acceptance of settlement risk on free settlement trades requires transaction specific or counterparty specific approvals from risk committees.

(c) Liquidity risk

Liquidity risk is the risk that the Bank will encounter difficulty in meeting obligations from its financial liabilities that are settled by delivering cash or another financial asset.

Management of liquidity risk

The Bank's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Bank's reputation. Liquidity risk exposures are measured by liquidity ratio limits established by the ALCO.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(c) Liquidity risk, continued

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

The liquidity position is monitored on a daily basis and regular liquidity stress testing is conducted under scenarios covering both normal and more severe market conditions. All liquidity policies and procedures are subject to review and approval by the ALCO. Weekly reports cover the liquidity position of local and foreign currency. A summary report, including any exceptions and remedial actions taken, is submitted regularly to the ALCO.

Exposure to liquidity risk

The key measure used by the Bank for managing liquidity risk is the maturity wise analysis, volatility measurements and stress testing. For this purpose, net liquid assets are considered to include cash and cash equivalents and investment grade debt securities for which there is an active and liquid market less any deposits from banks, debt securities issued, other borrowings and commitments maturing within the next month, including any statistical analysis of assets and liabilities that may not have a defined maturity.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(c) Liquidity risk, continued

The following table shows the undiscounted cash flows on the Bank's financial liabilities and assets on the basis of their earliest possible contractual maturity.

	Carrying amount	Gross Nominal (outflow) - inflow	Less than 1 month	1-3 months	3 months to 1 year	1-5 years	More than 5 years
December 31, 2016							
Liabilities							
Demand deposits from customers	\$ 33,416,267	(33,416,267)	(33,416,267)	0	0	0	0
Time deposits from customers	25,582,419	(26,274,360)	(3,772,417)	(6,272,491)	(9,072,523)	(7,040,127)	(116,802)
Total liabilities	\$ 58,998,686	(59,690,627)	(37,188,684)	(6,272,491)	(9,072,523)	(7,040,127)	(116,802)
Assets							
Cash and cash equivalents	\$ 68,000,285	68,000,285	68,000,285	0	0	0	0
Loans (Gross)	14,379,675	14,763,611	6,770,055	3,597,709	899,150	3,496,697	0
Total assets	\$ 82,379,960	82,763,896	74,770,340	3,597,709	899,150	3,496,697	0
December 31, 2015							
Liabilities							
Demand deposits from customers	\$ 13,997,495	(13,997,495)	(13,997,495)	0	0	0	0
Time deposits from customers	19,933,962	(20,542,000)	(880,000)	(4,813,000)	(6,782,000)	(8,067,000)	0
Total liabilities	\$ 33,931,457	(34,539,495)	(14,877,495)	(4,813,000)	(6,782,000)	(8,067,000)	0
Assets							
Cash and cash equivalents	\$ 56,086,814	56,086,814	56,086,814	0	0	0	0
Loans (Gross)	399,721	417,203	40,587	57,947	159,682	158,987	0
Total assets	\$ 56,486,535	56,504,017	56,127,401	57,947	159,682	158,987	0

(d) Market risk

Market risk is the risk that changes in market prices, such as interest rates, equity prices, foreign exchange rates and credit spreads (not relating to changes in the obligor's / issuer's credit standing) will affect the Bank's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the returns. Overall authority for market risk is vested in the ALCO. Risk committees are responsible for the development of detailed risk management policies (subject to review and approval by the ALCO) and for the day-to-day review of their implementation.

Management of market risks

Exposure to currency risk:

The Bank conducts all of its transactions denominated in United States dollars and therefore, is not exposed to any currency risk.

Exposure to interest rate risk – non-trading portfolios:

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(d) Market risk, continued

The Bank's operations are subject to the risk of interest rate fluctuations to the extent that interest earning assets and interest bearing liabilities mature or re-price at different times or in differing amounts. In the case of floating rate assets and liabilities, the Bank is also exposed to basis risk, which is the difference in re-pricing characteristics of the various floating rate indices. Risk management activities are aimed at optimizing net interest income, given market interest rate levels consistent with the Bank's business strategies.

The principal risk to which non-trading portfolios are exposed is the risk of loss from fluctuations in the future cash flows or fair values of financial instruments because of a change in market interest rates. The interest rate risk is managed principally through monitoring interest rate gaps and by having pre-approved limits for re-pricing bands, economic value of equity exposure, including on and off statement of financial position. The ALCO is the monitoring body for compliance with these limits and is assisted by Parent Company's Risk Management in its day-to-day monitoring activities.

A summary of the interest rate gap position on the Bank's financial instruments is shown below.

(Expressed in \$000's)	Days						
	Total	0-30	31-90	91-180	181-360	361-720	More than 720
December 31, 2016							
Assets							
Cash and cash equivalents	68,000	68,000	0	0	0	0	0
Loans (Gross)	14,380	5,058	5,000	4,322	0	0	0
Total	82,380	73,058	5,000	4,322	0	0	0
Liabilities							
Demand deposits	33,416	33,416	0	0	0	0	0
Time deposits	25,582	4,229	6,142	5,416	3,510	3,729	2,556
Total	58,998	37,645	6,142	5,416	3,510	3,729	2,556
Net interest gap	\$ 23,382	35,413	(1,142)	(1,094)	(3,510)	(3,729)	(2,556)

(Expressed in \$000's)	Days						
	Total	0-30	31-90	91-180	181-360	361-720	More than 720
December 31, 2015							
Assets							
Cash and cash equivalents	56,087	56,087	0	0	0	0	0
Loans (Gross)	399	42	0	0	0	357	0
Total	56,486	56,129	0	0	0	357	0
Liabilities							
Demand deposits	13,997	13,997	0	0	0	0	0
Time deposits	19,934	1,249	4,673	3,852	2,602	7,558	0
Total	33,931	15,246	4,673	3,852	2,602	7,558	0
Net interest gap	\$ 22,555	40,883	(4,673)	(3,852)	(2,602)	(7,201)	0

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

4. Financial risk management, continued

(d) Market risk, continued

Cash flow sensitivity analysis for variable rate instruments:

The management of interest rate risk against interest rate gap limits is supplemented by monitoring the sensitivity of the Bank's variable rate assets and liabilities. An increase or decrease of 100 basis points would have increased or decreased equity and profit or loss by \$75,297 (2015: \$78,586). This analysis assumes that all other variables remain constant. The analysis is performed using the same assumptions used in 2015.

Fair value Sensitivity analysis for fixed rate instruments:

The Bank does not account for any fixed rate instruments at fair value through profit or loss. Therefore a change in interest rates at the reporting date would not impact profit or loss.

(e) Operational risks

Operational risk is the risk of direct or indirect loss or damage in any form arising from a wide variety of causes associated with the Parent Company and Bank's processes, personnel, technology and infrastructure, and from external factors other than credit, market and liquidity risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behavior. Operational risks arise from all of the Bank's operations and are faced by all business entities.

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

As per Basel II, operational risk management is performed as a continuous process, with several distinct components:

- risk identification & assessment,
- risk mitigation (control development & implementation),
- control self-assessment (control testing),
- risk monitoring (key risk indicators follow up),
- risk measurement (incident collection & capital calculation), and
- control environment assessment & management (control culture measurement & corrective action implementation).

The primary responsibility for operational risk management is assigned to senior management within each business unit. This responsibility is supported by the development of overall policies and a central unit (Parent Company's Operational Risk Management Department) coordinates and follows up on the business unit's performance. Status and developments are reported to a bi-monthly Operational Risk Committee, which oversees the risk management cycle. Additionally, compliance with the Bank's policies is supported by periodic reviews undertaken by the Parent Company's Internal Audit department. The results of internal audit reviews are discussed with the business unit's management and then summaries are submitted to the Audit Committee and senior management of the Bank.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

4. Financial risk management, continued

(f) Capital management

The Central Bank of The Bahamas requires the Bank to maintain a minimum ratio of total capital to risk-weighted assets of 8%. The capital to risk-weighted assets ratio at December 31, 2016 was 82.77% (2015: 192.15%).

The Bank's policy is to maintain a strong capital base so as to maintain the confidence of stakeholders and to sustain future development of the business. The Bank has complied with all externally imposed capital requirements throughout the year.

There were no changes in Bank's approach to capital management during the year.

5. Critical accounting estimates and judgments in applying accounting policies

The Bank's Management is responsible for the development, selection, disclosure of policies and critical accounting estimates and their implementation in a manner consistent with the assumptions selected and related to the significant estimate uncertainties.

The Bank reviews its loan portfolio to assess the impairment at least on a quarterly basis. When determining whether an impairment loss should be recorded in the statement of comprehensive income, the Bank makes decisions as to whether observable information exists indicating that there is a measurable reduction in estimated future cash flows from a loan portfolio before such reduction may be identified with an individual loan in that portfolio. This evidence includes observable information indicating that an adverse change in the payment condition of borrowers in a group, or national or local economic conditions that correlate with non-compliance instances in Bank's assets have occurred. Management determines estimates based on the experience of historical loss by assets with similar credit risk similar characteristics and objective evidence of impairment.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

6. Related party balances and transactions

Balances and transactions with related parties are shown below:

	2016	2015
Assets		
Cash and cash equivalents	\$ 64,388,310	40,161,779
Loans to customers, net	5,000,000	0
Accrued Interest and other receivables	16,111	0
Liabilities		
Demand deposits from customers	\$ 26,744,679	4,564,919
Time deposits from customers	1,104,121	1,101,017
Accrued interest payable	2,766	2,636
Other liabilities	43,019	26,956
Income		
Interest income	\$ 2,278,566	1,590,307
Other income	37,824	37,272
Expenses		
Interest expenses	\$ 36,562	19,270
General and administrative	60,000	60,000

During the current year, related parties charged the Bank \$60,000 (2015: \$60,000) for administrative services.

During 2016, the Bank acquired certain loans from a related party at book values amounting to \$17,509,635.

7. Cash and cash equivalents

The geographical distribution of cash and deposits in banks by country of the head office is as follows:

	2016	2015
Panama	\$ 59,723,758	39,813,441
The Cayman Islands	4,249,180	15,916,961
United States of America	3,590,236	348,171
Costa Rica	415,372	8,074
The Bahamas	21,739	167
	\$ 68,000,285	56,086,814

At December 31, 2016, cash and cash equivalents earned interest at rate ranging between 0.00% to 4.00% (2015: 0.00% to 3.75%) per annum.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

8. Loans to customers, net

At December 31, 2016, the loan portfolio was segmented by industry as follows:

	2016	2015
Consumer	\$ 57,599	42,051
Commercial	14,322,076	357,670
	14,379,675	399,721
Less allowance for loan losses	(28,173)	(921)
	\$ 14,351,502	398,800

At December 31, 2016 and 2015, the Bank did not have non-accrual or past due loans. At December 31, 2016, commercial loan earn interest at ranging between 3.00% to 4.37%, (2015: 4.23%) per annum.

The changes in the allowance for loan losses are presented below:

	2016	2015
Balances at beginning of year	\$ 921	1,055
Provision (reversal) for loan losses	27,252	(134)
Balance at end of year	\$ 28,173	921

9. Demand deposits from customers

At December 31, 2016 and 2015, demand deposits are from customers primarily domiciled in Central America. Demand deposits bear interest at various rates up to 0.05% (2015: 0.05%) per annum.

10. Time deposits from customers

At December 31, 2016 and 2015, the time deposits were due within one year with annual interest rates ranging between 1.25% to 6.00% (2015: 1.00% to 6.00%) and are from customers primarily domiciled in Central America.

11. Share capital

At December 31, 2016 and 2015, share capital is represented by 18,000,000 ordinary registered shares of \$1.00 par value each, for a total of \$18,000,000.

12. General and administrative expenses

General and administrative expenses are shown below:

	2016	2015
Personnel	\$ 422,844	361,714
Corporate services	60,000	60,000
Outside services	63,961	69,424
Depreciation	2,899	2,938
Other	283,705	289,550
	\$ 833,409	783,626

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

13. Taxes

The Bank is exempt from income tax payments under the laws of The Commonwealth of The Bahamas. In accordance with the current tax regulations in Panama, the Bank is exempt from the payment of income taxes on profits derived from foreign operations. In addition, profits derived from interest earned on time deposits and interest earned from Panama Government securities is also exempt from the payment of income taxes.

14. Measurement of fair values

The fair value of a financial asset or liability 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 (exit price).

The Bank conducts a fair value estimate in accordance to IFRS 13. The different hierarchy levels have been defined as follows:

- Level 1 - Quoted prices in active markets without adjustments for identical assets or liabilities that the Bank can access at the measurement date.
- Level 2 - inputs other than quoted prices included in Level 1 that are observable, either directly (i.e. as prices) or indirectly (i.e. derived from prices). This category includes instruments valued using quoted prices in active markets for similar instruments, quoted prices for identical or similar instruments in markets that are not active and other valuation techniques where significant data inputs are directly or indirectly observable in the market.
- Level 3 - unobservable inputs for the asset or liability. This category includes all instruments where the valuation technique includes unobservable inputs and these have a significant effect on the fair value measurement. This category also includes instruments that are valued based on quoted prices for similar instruments for which we must make significant adjustments using unobservable inputs, assumptions or adjustments in which no observable or subjective data are used when there are differences between the instruments.

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016
(Expressed in United States dollars)

14. Measurement of fair values, continued

A market is considered active if quoted prices are readily and regularly available from an exchange, financial intermediaries, a sector institution, pricing service or regulatory agency, and those prices reflect actual market transactions with sufficient frequency and volume to provide pricing information market.

Fair values have been determined for measurement and/or disclosure purposes based on the following methods.

(a) *Cash and cash equivalents*

The carrying amounts approximate fair value because of the short-term maturities of these instruments.

(b) *Loans to customers*

The fair value of loans to customers is estimated by discounting future cash flows using the interest rates offered for loans with similar characteristics.

(c) *Demand and time deposits*

The fair value of demand deposits is the amount payable on demand at the reporting date. The fair value of time deposits is estimated by discounting future cash flows using the rates offered for deposits with similar remaining maturities.

As of December 31, 2016 the following table sets out the fair values of Bank's significant financial instruments not measured at fair value and analyses them by the level in the fair value hierarchy into which each fair value measurement is categorized. The fair value information for the financial assets and financial liabilities whose carrying amounts approximate their fair values (such as cash and cash equivalents and demand deposit) are not included in this table.

	Level 1	Level 2	Level 3	Total fair value	Total carrying Amount
December 31, 2016					
Assets:	\$				
Loans to customers, net	0	0	14,323,936	14,323,936	14,351,502
Liabilities:					
Time deposits from customers	0	0	25,560,380	25,560,380	25,582,419
December 31, 2015					
Assets:	\$				
Loans to customers, net	0	0	397,569	397,569	398,800
Liabilities:					
Time deposits from customers	0	0	20,087,577	20,087,577	19,933,962

BAC BAHAMAS BANK, LIMITED

Notes to Financial Statements, Continued

Year ended December 31, 2016

(Expressed in United States dollars)

15. Reserve for loans losses (regulatory requirements)

The Parent Company is regulated by the Superintendent of Banks of Panama (“Superintendent”). In 2013, the Superintendent issued the Agreement No. 004-2013 (“the Agreement”) setting out certain requirements for the management and administration of the inherent credit risk pertaining to off balance operations of banks in Panama.

The Agreement is applicable to the Bank as certain regulations applicable to the Parent Company are also applicable to its subsidiaries.

Among other matters, this Agreement defines the classification categories of credit facilities for the specific and dynamic provisions as well as the criteria that the policies for restructured loans, financial guarantees, and charge off operations should contain. The dynamic provisions were established by the Superintendent, as prudential regulation, in order to meet future needs of specific provisions. The Specific provision for impairment of the loan portfolio should be determined and recognized in the financial statements in accordance with the credit facilities’ classification within the risk categories currently in use and calculated based on minimum percentages weighted by each category specified in the Agreement. The Agreement also requires establishing the dynamic provision, to be determined and recognized quarterly as reserves in equity following certain calculation criteria and restrictions that will be implemented gradually.

The Agreement establishes that the dynamic reserve cannot be less than 1.25% or greater than 2.50% of risk-weighted assets related to credit facilities classified as normal. Accordingly, at December 31, 2016, the Bank, is required to establish a reserve/ provision in the amount of \$308,812 (2015: \$5,988), as part of equity through the appropriation of retained earnings.

Furthermore, the Central Bank of The Bahamas does not expect that general allowance for loan losses should be less than 1% of the total loan portfolio, which amounts to \$143,797 (2015: \$3,997).

While the Bank is required to establish and/or maintain loan losses reserves, as described above, based on management’s assessment, the required total allowance for loan losses calculated in accordance with IFRS as at December 31, 2016 amounted to \$28,173 (2015: \$921). Therefore, the Bank has established a reserve of \$308,812 (2015: \$5,988), which is the maximum requirement of its regulators as at December 31. The difference between the maximum requirement of its regulators and the IFRS allowance for loan losses, has been recognized in the equity section of the statement of financial position by making an appropriation and transfer from retained earnings.