

GULF INTERNATIONAL BANK



2005



ANNUAL REPORT

GIB
بنك الخليج الدولي

TELECOM



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GULF INTERNATIONAL BANK

Gulf International Bank is a leading merchant bank in the Middle East with its principal focus on the Gulf Cooperation Council (GCC) states. With a proven track record spanning 30 years, GIB provides client-led, innovative financial products and services. Its client base includes major private-sector corporations, Gulf-based financial institutions, multinational companies active in the region and the governments of the GCC states.

GIB has gained an international reputation for project and trade finance and is a leading player in the regional syndicated loan market. Its other primary business areas include merchant banking services such as investment banking, capital markets and asset management.

GIB's financial strength is based on conservative asset and liability management policies, its high-quality asset profile and strong capital base.

The Bank was established in the Kingdom of Bahrain in 1975. The six GCC governments, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, own 72.5 per cent of the Bank, while the Saudi Arabian Monetary Agency owns 27.5 per cent. In addition to its main subsidiary Gulf International Bank (UK) Limited, the Bank has branches in London, New York, Riyadh and Jeddah, and representative offices in Beirut and Abu Dhabi.



THE GULF'S OWN MERCHANT BANK

FINANCIAL HIGHLIGHTS

	2005	2004	2003	2002	2001
Earnings (US\$ millions)					
Net Income after Tax	203.0	150.2	106.1	85.3	100.5
Net Interest Income	179.1	173.1	167.3	195.7	193.4
Other Income	169.1	123.5	120.3	88.4	70.3
Operating Expenses	138.7	124.4	126.1	115.6	118.1
Financial Position (US\$ millions)					
Total Assets	22,856.6	19,239.0	17,454.6	16,388.7	15,384.2
Available-for-Sale Securities	7,839.6	8,469.1	8,451.8	8,280.4	7,641.7
Loans	7,215.9	5,438.5	3,911.8	3,408.0	3,461.6
Term Financing	1,944.5	1,678.3	1,501.3	880.0	830.0
Total Equity	1,718.3	1,586.6	1,440.7	1,180.1	1,245.6
Ratios (Per cent)					
Profitability					
Return on Average Equity	12.3	9.9	8.1	7.0	7.7
Return on Average Assets	1.0	0.8	0.6	0.5	0.7
Capital					
BIS Risk Asset Ratio					
- Total	12.7	11.0	12.0	12.8	12.6
- Tier 1	9.2	9.7	10.4	10.3	10.2
Equity as % of Total Assets	7.5	8.2	8.3	6.9	7.8
Asset Quality					
Securities as % of Total Assets	43.1	52.4	57.5	57.9	56.2
Loans as % of Total Assets	31.6	28.3	22.4	20.8	22.5
Liquidity					
Liquid Assets Ratio	66.8	70.2	76.0	77.2	74.3
Deposits to Loans Cover (times)*	2.1	2.3	3.1	3.2	3.2

* Deposits include Term Financing

Credit Ratings

	Fitch	Moody's	Standard & Poor's	Capital Intelligence
Long-term	A-	A3	A-	A
Short-term	F2	P-2	A-2	A2
Individual	C			
Financial Strength		C-		A-
Outlook	Stable	Stable	Stable	Stable

BOARD OF DIRECTORS

H.E. SHEIKH EBRAHIM BIN KHALIFA AL-KHALIFA

Chairman
Undersecretary, Ministry of Finance
Kingdom of Bahrain

MR. ABDUL AZIZ M. AL-ABDULKADER

Vice Chairman
President, AMA Group
Kingdom of Saudi Arabia

MR. BADER ABDULLAH AL-RUSHAID AL-BADER

Ex-Chairman and Managing Director
Kuwait Investment Company
State of Kuwait

DR. HAMAD BIN SULAIMAN AL-BAZAI

Deputy Minister for Economic Affairs
Ministry of Finance
Kingdom of Saudi Arabia

MR. SAUD BIN NASSIR AL-SHUKAILY

Secretary General for Taxation
Ministry of Finance
Sultanate of Oman

DR. KHALID BIN ABDULLA AL-SWEILEM

Director General, Investment Department
Saudi Arabian Monetary Agency
Kingdom of Saudi Arabia

MR. KHALID BIN ABDULLA AL-SUWAIDI

Office Director at the Deputy Secretary General's Office
The Supreme Council for Economic Affairs and Investment
State of Qatar

MR. NASSER KHAMIS AL-SUWAIDI

Director of the Minister's Office
Ministry of Finance and Industry
The United Arab Emirates

DR. ABDUL RAHMAN BIN AHMED AL-JAFARY

Gulf Organisation for Industrial Consulting
Kingdom of Saudi Arabia



GIB offers a wide range of innovative financial solutions, both traditional and Islamic. In 2005, the Bank acted as the lead arranger, book runner and facility agent in a US\$750 million Islamic Murabaha facility for Mobile Telecommunications Company (MTC).

CHAIRMAN'S STATEMENT



Sheikh Ebrahim Bin Khalifa Al Khalifa
Chairman

ON BEHALF OF THE BOARD OF DIRECTORS, it is my privilege to present the annual report of Gulf International Bank (GIB) for the year ended 31st December 2005.

I am pleased to report that 2005 was yet another record year for GIB. With significant improvements continuing across all major business activities, the Bank recorded the highest profit level in its history. Net income after tax rose by 35.2 per cent to US\$203.0 million, eclipsing the previous record of US\$150.2 million in 2004.

This exceptionally strong year-on-year advance reflects increases in both interest and non-interest earnings and a reduction in provisions for credit losses, demonstrating the success of GIB's ongoing strategic initiatives, coupled with an effective and proactive management of risk. The result clearly illustrates the soundness of the Bank's new merchant banking strategy introduced four years ago, focusing primarily on the Gulf Cooperation Council (GCC) states, which has increasingly contributed to a diversification of earnings. In 2005, GIB

continued to provide shareholders with enhanced returns, while maintaining favourable recognition from clients, counterparties, supervisory authorities, international credit rating agencies and market monitors.

The global economic recovery continued at a resilient pace during the year, in spite of wide divergences in average growth levels across regions. Underpinning this have been healthier market conditions, improving credit quality, renewed investor confidence and strengthened manufacturing and trade across the globe. Within this generally favourable macroeconomic environment, concerns remain over the long-term effects of ascending oil prices, which have resulted in increased global current account imbalances. Inflationary pressures are showing signs of picking up but still remain at moderate levels. This has been accompanied by tightening nominal and real interest rates.

Economic prospects for the GCC region remain robust, buoyed by higher oil production and prices, expansionary fiscal policies, favourable interest rates, and a growing

CHAIRMAN'S STATEMENT continued

tendency toward inward investment opportunities. This has substantially enhanced liquidity levels, and enabled the region to accumulate fiscal and current account surpluses. As a result, public spending in major infrastructure and industrial projects has been boosted, with regional governments and public sector entities increasingly tapping financial markets for their funding requirements, including the use of Islamic instruments. Of significant mention is the enhanced share of the private sector in the current economic expansion, including investments (domestic and foreign) into the equity and real estate markets, tourism sector and industry.

GIB's business activities benefited from this strong growth momentum in the region. The Bank participated in a record number of major projects and transactions, and maintained its status as the primary provider of project and structured finance services in the Middle East and North Africa region. It also consolidated its position as the leading financier and arranger specialising in oil, gas, petrochemical, power generation, and manufacturing sector projects. At the same time, GIB expanded its capabilities in other areas, such as shipping finance, secondary market loan asset trading, and Islamic finance, and remained the region's most active financial institution in the loan agency business.

In addition to increased revenues from merchant banking activities, it is encouraging to note that fees from investment banking, advisory and management services continued to grow in healthy proportion. During 2005, this important source of fee-based income totalled US\$29.8 million, an increase of 26.3 per cent over 2004.

Strong and stable revenues from Treasury's portfolio of investment-grade securities continued to underpin the GIB Group's core earnings in 2005. The securities portfolio is the largest asset category in the Group's balance sheet, and

besides its core earnings contribution, it provides effective risk diversification and ready liquidity. Outstanding results were also achieved from Treasury's investment and trading activities across several other asset classes, while a substantial increase in profits from foreign exchange dealings resulted from enhanced client-related business.

A change in the Group's shareholding structure took place during the year, with the Saudi Arabian Monetary Agency (SAMA) acquiring the 5.3 per cent stake of JP Morgan Chase and Co., bringing SAMA's shareholding in the Bank to 27.5 per cent. This change was necessary to eliminate any possible conflict of interest due to the granting of a banking licence to JP Morgan to establish a branch in the Kingdom of Saudi Arabia.

I am very pleased to also report that during the year, GIB received important upgrades to its long-term foreign currency ratings by the international credit rating agencies: Moody's - up to 'A3' from 'Baa1', Standard & Poor's - up to 'A-' from 'BBB+', and Capital Intelligence - up to 'A' from 'A-'. These follow an upgrade by Fitch in December 2003 - up to 'A-' from 'BBB+'. GIB is now rated A-/A3 by Fitch, Moody's and Standard & Poor's and remains one of the highest rated financial institutions in the Middle East. These latest upgrades should have a direct and beneficial impact on the Group's cost of funding.

Reflecting this positive ratings development was GIB's success in raising US\$1.2 billion of new term financing during 2005, which also provides testimony to the confidence placed by the local, regional and international financial community in the strength and capacity of GIB. The Bank's regional leading role in capital raising was reaffirmed in April with the finalisation of a US\$800 million syndicated five-year term deposit facility. This was the largest syndicated term finance facility raised to date by

a regional financial institution; it was supported by a diverse group of leading international and regional banks.

In October, GIB's pioneering role in the development of the region's capital markets was also reaffirmed by the issue of a US\$400 million 10-year subordinated floating rate note (FRN). In this groundbreaking transaction, GIB became the first financial institution in the Middle East to issue a Tier 2 subordinated note. Almost four times oversubscribed, the size of the issue was increased from US\$300 million to US\$400 million, following exceptionally high demand from investors. Most significantly, over 75 per cent of investors were from outside the region, representing institutional investors from Europe, the United States and Asia, many of whom were new to both GIB and the region.

GIB remains committed to its vision of becoming the 'merchant bank of choice' in the GCC. Supporting this aspired leadership role is the Bank's total commitment to implementing the highest international standards of corporate governance. Throughout 2005, GIB continued to improve its processes to enhance transparency, disclosure and compliance, and further strengthened its risk management framework. In addition, substantial investment was made in enhancing the Bank's human capital and technical resources to make GIB a more professional, responsive, and efficient financial institution. This will enable the Bank to take full advantage of the increasing opportunities throughout the region, by continuing to develop its specialist treasury, asset management, investment banking, and project and structured finance skills, for the benefit of all GIB stakeholders.

Finally, I would like to take this opportunity to express my gratitude to our retiring Board member, Mr. Mark Garvin, for his diligent and valuable contribution to GIB's

success during his tenure. In turn, I welcome our new Director, Dr. Abdul Rahman Bin Ahmed Al-Jafary. His wealth of experience in the fields of academia, industry, management and finance are invaluable in assisting the Board of Directors in carrying out its duties and responsibilities.

On behalf of the Board of Directors, I would like to express my sincere appreciation for the ongoing support and loyalty of GIB's shareholders and clients, for the professionalism and dedication of the Bank's management and staff, and for the constructive cooperation that GIB continues to receive from the regulatory and supervisory authorities.

Ebrahim Bin Khalifa Al Khalifa

Chairman



GIB is active in the civil aviation arena. In 2005, the Bank was joint lead arranger in an Emirates Airlines' US\$550 million bond issue.

MANAGEMENT REVIEW

A SUSTAINED GLOBAL ECONOMIC RECOVERY, coupled with a robust regional economic performance has stimulated substantial vigour in GIB's business environment since the introduction of its new merchant strategy four years ago. As a result, there have been strong contributions across all major operating activities, enabling the Bank to achieve record levels in financial performance.

Prospects for 2006 continue to look encouraging. This is supported not only by the robust economic expansion and diversification underway in the GCC and regional markets, but also by GIB's more balanced earnings profile, its recently upgraded international credit ratings, and an increased focus on marketing and new business development. In addition, demand for merchant and investment banking services is expected to increase as important structural reforms in the GCC's financial infrastructure gather pace.

ECONOMIC AND BUSINESS OVERVIEW

Global economic growth continues to expand at a healthy pace. After rising by an average of 5.1 per cent during 2004, growth was sustained at similar levels throughout 2005. Major stock markets around the world continued their strong trading momentum, with emerging markets again enjoying higher than average returns. On commodity exchanges, crude oil and precious and base metals were major performers.

The strong growth momentum of regional economies has boosted confidence across the GCC governments and businesses, with local economies and markets enjoying greater prosperity. A key underlying influence is the generally high level of oil prices. This has fuelled regional liquidity levels, enabled the accumulation of substantial

fiscal and current account surpluses, and enhanced the favourable risk profiles of the GCC countries.

The economic reform momentum gathered pace across the region during 2005. Improved transparency in fiscal policy and government finances; enhanced capital market regulation; increased foreign ownership and competition; and changes in labour laws; are just some of the positive developments benefiting the GCC economies. Vibrant private sector activity and increased prospects for privatisation provide further stimulus to economic growth.

The Gulf region's potential to further bolster its position, as one of the world's rapidly expanding and attractive economic areas, remains significant. Many GCC companies and financial institutions are advantageously positioned to benefit from a vast array of opportunities in a number of economic sectors. Also, key social and demographic factors, such as a youthful demographic profile, increasing life expectancy, and growing disposable incomes, add to the region's attraction in areas such as light manufacturing and services.

In addition, internal and external resource mobilisation continues to improve. Domestically, this is happening through more sophisticated fiscal and monetary management, and effective financial market intermediation, which together have been conducive to encouraging greater confidence to invest in the region rather than abroad. External factors supporting this trend include the lengthening of maturity terms of international financings in support of long lead times for major, world-scale hydrocarbon and industry developments. As a committed party to this process, GIB remains confident in the ability and capacity of GCC states to continue evolving the market mechanisms and institutions required to support entrepreneurship and investment, and to deliver sustainable economic growth.

MANAGEMENT REVIEW continued

MERCHANT BANKING

Throughout 2005, the Merchant Banking group successfully continued to implement GIB's strategy within the GCC region. The group's operations were further streamlined during the year to support the Bank's ambitious growth targets and exploit the growing opportunities in project finance and corporate finance, particularly in the GCC markets, and also to identify profitable investment opportunities to utilise the region's substantially increased liquidity. In recognition of clients' growing expectations for financial advisers to play an additional role as funds provider to projects, an integrated approach to providing corporate finance services was adopted among the project advisory, project finance, Islamic banking, syndication and capital market teams. This has enabled the group to develop inherent synergies and also provide clients with a focused response to their needs.

“Underwriting and advising on the raising of funds by corporate customers for new projects, as well as expansion of existing projects, has been the core activity of the group.”

The group also took steps to promote its market profile and develop its resources in order to take advantage of the growing regional activity in the issue of bonds and other financial instruments. Asset-trading activities were expanded to include trading in long-term project loans, structured trade finance paper and institutional loans, with a view to promoting a more active secondary market in the region and thereby opening up new avenues for investment of liquid funds by GIB's clients. The consolidation of

product and distribution functions into a single platform, which was achieved in 2004, has further strengthened the Bank's client relationships and the expansion of cross-selling opportunities.

During the past few years, the demand for Islamic financial structures and products has witnessed exponential growth across the region. Anticipating this trend, GIB has continued to raise its profile in the Islamic banking market by increasing its range of Sharia'a-compliant services. These now include project financing, structured finance, syndicated lending and corporate finance, which are provided to a wide client base, including major private sector corporations, multinational organisations, Gulf-based Islamic financial institutions, and governments of GCC states.

Merchant Banking improved its contribution to the overall income of the Bank in 2005 through the implementation of a carefully formulated business development strategy that focuses on increased market penetration and product diversification. Underwriting and advising on the raising of funds by corporate customers for new projects, as well as expansion of existing projects, has been the core activity of the group. Latest analysis by international market monitors confirms that GIB maintained its position as the primary provider of project and structured finance services in the MENA region for the fifth year running. The Bank was also a significant underwriter and arranger of term finance for financial institutions in the region during 2005. The Bank played a leading role in the financing of numerous large projects in oil and gas, petrochemicals, steel and aluminium, water and electricity, telecommunications and infrastructure developments. GIB's involvement in these transactions at the lead level is an endorsement of its distribution capabilities in the region. The Bank also expanded its capabilities in asset finance as well as remaining the region's

“The Bank played a leading role in the financing of numerous large projects in oil and gas, petrochemicals, steel and aluminium, water and electricity, telecommunications and infrastructure developments.”

most active financial institution in the loan agency business.

Saudi Arabia constitutes GIB’s largest market, and merchant banking marketing activities across the Kingdom were enhanced by the successful first full year’s operations of the Jeddah branch. In addition, GIB ranked second as a mandated lead arranger in financing financial institutions in the GCC countries. In the first ever independent water and power project financing transaction to be launched in the Kingdom for the Shuaibah Water and Electricity Company, which was concluded in December 2005, GIB played a key role by acting as the sole mandated lead arranger and facility agent.

In Kuwait, the Bank maintained its active role in providing financing for the corporate sector during 2005. GIB acted as lead arranger, book runner and facility agent in the US\$750 million Islamic Murabaha facility for Mobile Telecommunications Company (MTC), which was signed in December 2005. In addition, GIB acted as: mandated lead arranger for a syndicated term loan for Public Warehousing Company; joint arranger and underwriter for a syndicated loan for National Industries Group; and mandated lead arranger for a Murabaha facility for Kuwait Finance House.

In Bahrain, GIB acted as mandated lead arranger for a syndicated term loan for the latest refinery expansion project by Bahrain Petroleum Company, and also

undertook the role of commercial facility agent. An Islamic Murabaha facility was arranged for Shamil Bank, with GIB acting as the coordinating mandated lead arranger and facility agent. The Bank supported the successful bidding consortia of developers in the second independent water and power project at Hidd, and acted as one of the lead arrangers for a credit package of US\$1.2 billion.

In Qatar, GIB continued its support for the country’s fast-expanding industrial sector, where it acted as a mandated lead arranger for two large-scale LNG projects: a syndicated loan for the RasGas expansion programme and another syndicated loan to Qatar Gas 3 project; two large scale greenfield petrochemical projects: a syndicated loan for the Qatofin project and a syndicated loan for the Q-Chem II project; and a term facility club deal for Qatar Steel Company. The Bank acted as a mandated lead arranger and book runner in a syndicated loan for Q-Power, the second independent water and power project in Ras Laffan Industrial City.

GIB was mandated as a lead arranger for four large hydrocarbon-based projects in Oman during 2005: a refinancing term facility for Oman LNG; a syndicated loan for the greenfield Qalhat LNG project; a syndicated term facility for Aromatics Oman; and a term facility for Oman Refinery Company. The Bank also acted as a mandated lead arranger and Islamic facility agent in a dual tranche project finance facility for Sohar Aluminium, the first aluminium smelter in Oman.

In the United Arab Emirates, GIB was involved in three large Islamic financing transactions. The Bank acted as mandated lead arranger for an Istisna’a / Ijara facility for Dolphin Energy; a joint lead manager for a Sukuk Al-Ijaraa for Dubai Civil Aviation for expansion of Dubai Airport; and a joint lead manager in a Sukuk Al-Musharaka issue to finance construction of the new headquarters building for Emirates Airlines.

MANAGEMENT REVIEW continued

GIB maintains a presence outside the GCC region through its branches in London and New York, and its representative office in Beirut. Based on significant trade flows and long-term relationships within the GCC, the Bank's international trade finance and institutional lending business is mainly conducted in the MENA region. In 2005, the Bank increased its support for international contractors and sponsors involved in projects in the region through the issue of performance and project-related guarantees, and working capital facilities.

“In 2005, GIB retained its regional role as a pre-eminent adviser and arranger for private placements and IPOs.”

INVESTMENT BANKING

Against a backdrop of record activity by the GCC's stock markets, GIB continued to grow its investment banking business in 2005. Regional governments continued their policy of strengthening and expanding their capital markets, introducing additional regulatory standards, and encouraging more companies to list their shares. Improved market conditions have resulted in growing investor interest in regional equity markets, while increased liquidity has served to increase the depth of capital markets in terms of new listings and growth in overall market capitalisation. The market capitalisation of the region's stock exchanges grew to over US\$1,120 billion in 2005 - more than double the figure for 2004 - with Saudi Arabia and the UAE taking the lead. There was a marked increase in IPO activity, with the listing of 41 new companies in total raising

over US\$5.5 billion compared to US\$3.9 billion the previous year.

In 2005, GIB retained its regional role as a pre-eminent adviser and arranger for private placements and IPOs. The Bank acted as the exclusive financial adviser for the SR1.5 billion (US\$400 million) IPO involving the sale of three million shares for Bank Al-Bilad, which brought together eight of Saudi Arabia's former money exchanges to form a new financial institution. GIB was also mandated to arrange the IPO for AlBaraka Banking Group in Bahrain, which is expected to take place during 2006. Other investment banking achievements by GIB in 2005 included acting as the exclusive financial adviser for the increase of US\$933 million to the existing SR6 billion (US\$1.6 billion), 15-year syndicated structured debt facility for Saudi Electricity Company. The Bank also maintained its status as the regional leader in the provision of project advisory services, and is one of the few financial institutions in the GCC with a dedicated, professional advisory team. In 2005, GIB advised Crown Paper Mill Company in the UAE on placing 51 per cent of the company with Gulf Investment Corporation. Other mandates were also won in various GCC countries, and these are expected to be implemented during 2006.

“The Bank also maintained its status as the regional leader in the provision of project advisory services, and is one of the few financial institutions in the GCC with a dedicated, professional advisory team.”

FINANCIAL MARKETS AND ASSET MANAGEMENT

Aided by the continued recovery of global markets in 2005, GIB's financial markets and asset management business enjoyed its most successful year to date. Client assets under management by the Bank's UK-based investment banking subsidiary - GIBUK - grew to a record total of US\$18 billion, and have nearly tripled in the past three years, reinforcing GIB's status as the largest Arab-owned commercial manager of client assets in the GCC region. Fees derived from the discretionary portfolio and fund management activities also continued to rise, with the prospect of further growth based on a sustainable platform. Financial markets trading also enjoyed significant profitability, reflecting the successful application of a diverse array of rigorously developed trading strategies.

Complementing its unique franchise as the only Gulf-based institution with an in-house global asset management capability, the specialist skills-set of the GIBUK team was recognised by Fitch Ratings during 2005. The Agency affirmed the Bank's CDO asset manager rating of 'CAM2', which was assigned in August 2004 and represents the highest ratings achieved by a structured products manager in Europe. According to Fitch, this rating 'continues to reflect GIB's solid experience in asset backed securitisations (ABS) and collateralised debt obligations (CDO) management, its mature business franchise, robust control environment, and proven credit selection and administration capabilities'.

In 2005, GIB also continued to develop its structured products range, utilising its extensive experience gained from trading these securities on its own account and for the benefit of a growing client base in Europe, with institutional funds now worth more than US\$2 billion.

“Client assets under management... grew to a record total of US\$18 billion, and have nearly tripled in the past three years, reinforcing GIB's status as the largest Arab-owned commercial manager of client assets in the GCC region.”

Following issues during the last three years of Euro and Sterling denominated CDOs, in 2005 GIB confirmed its status within Europe as a leading manager of mezzanine ABS products, through the issue of a fourth CDO. The Euro 305.6 million FAB CBO 2005-1 is backed by a portfolio of senior, mezzanine and junior asset-backed and synthetic securities.

Recognition of GIB's sound investment approach was also provided in 2005 by Standard & Poor's (S&P). The Agency assigned its 'AAAF' fund credit quality rating and 'S1+' fund volatility rating to the Enhanced Liquidity Management Fund (ELMF). The assigned 'AAAF' rating is the highest possible credit rating to be assigned by S&P. The 'S1+' volatility rating recognises the portfolio's extremely low sensitivity to changing market conditions, and is the best possible volatility measure that S&P can assign. ELMF was launched in August 2001 as a liquid, secure and attractive alternative to bank deposits, and has consistently generated returns in excess of one-month US dollar LIBOR rates.

GIB's UK-based investment team manages a range of internationally oriented investment products and assets, operating through three market groups. Equity markets cover global and regional equities and convertibles;

MANAGEMENT REVIEW continued

credit markets cover investment grade and high yield corporate debt and asset-backed securities; while government markets cover developed and emerging market bonds, interest rates and currencies.

TREASURY

Treasury is responsible for the Group's funding activities and capital market investment activities, and also manages the balance sheet. Over the years, it has successfully established GIB as a leading name in international and regional money markets, and built itself a reputation as a reliable and professional business partner. It offers a wide range of treasury and capital market products and services to a diverse client base consisting of regional corporates, conventional and Islamic financial institutions and government entities; it also implements customised hedging strategies on behalf of the Bank's customers.

In 2005, Treasury posted another record performance, continuing to make a substantial contribution to GIB's net income. This was achieved in a year of mixed market conditions, highlighted on the one hand by moderate inflation levels, improved credit quality and renewed investor confidence; and on the other hand by a tightening of nominal and real interest rates.

Treasury's significant portfolio of investment-grade-rated floating rate securities, with a value in excess of US\$7 billion, continues to underpin the Bank's investment activities. This available-for-sale debt securities portfolio is highly liquid and generates a stable income stream, as well as providing considerable diversification of risk. In addition, Treasury makes selective investments in specialised markets and asset classes through external fund managers in line with the Bank's policy to seek an asset mix with adequate diversification. Those investments performed well in 2005, with some funds

producing exceptionally strong returns. Owing to the prevailing market conditions in 2005, Treasury experienced strong foreign exchange flows from customers and increased demand for derivatives to hedge their interest and currency risks. This trend is expected to continue in 2006.

In line with the Bank's strategic objective to lengthen the maturity of its funding, a total of US\$1.2 billion of new term financing was raised during 2005. US\$800 million of this funding resulted from a five-year term deposit facility

“In line with the Bank's strategic objective to lengthen the maturity of its funding, a total of US\$1.2 billion of new term financing was raised during 2005.”

arranged by a diverse group of leading international and regional banks, and was increased from the original launch amount of US\$750 million due to widespread interest. Significantly, this is the largest syndicated term finance facility raised to date by a regional financial institution. In addition, US\$400 million was raised by the issue of a 10-year subordinated Floating Rate Note (FRN), making GIB the first financial institution in the Middle East to issue a Tier 2 subordinated note. Nearly four times oversubscribed, the issue was increased from the original launch amount of US\$300 million following exceptionally high demand from investors, of whom over 75 per cent were from outside the region – from Europe, the United States and Asia. Many of these investors were new to both GIB and the Middle East.

These successful term financings illustrate the confidence placed in the strength and capacity of GIB by the local, regional and international financial community, and underlines the upgrades in the Bank's long-term

foreign currency ratings by Moody's, Standard & Poor's and Capital Intelligence during 2005. The subordinated FRN has been approved by the Bahrain Monetary Agency for inclusion in Tier 2 regulatory capital. This enhancement of the Bank's regulatory capital base will facilitate its planned asset growth and further improve GIB's liquidity profile. Another highlight of the Group's balance sheet development during the year was the significant increase in customer deposits, which has further enhanced the Bank's funding quality.

GCC capital markets witnessed further successful bond issues in 2005, including conventional floating rate notes and the increasingly popular Islamic bond instruments known as Sukuks. GIB participated in these issues, illustrating its strategic commitment to the region, and further reinforcing its dominant position in the Gulf's banking industry.

RECOGNITION

GIB's financial standing was enhanced during the year by an upgrade in its long-term foreign currency ratings by the major international rating agencies, and by its success in raising US\$1.2 billion of long-term financing in the global markets. Moody's Investors Service, Standard & Poor's and Capital Intelligence upgraded GIB's rating during the year to "A3", "A-" and "A" respectively.

The Bank's reputation was further endorsed by a number of prestigious industry awards received in 2005. These include 'Bank of the Year 2005 in Bahrain' by The Banker magazine, and two awards from the New York-based Global Finance magazine: 'Best Bank in Bahrain in 2005' and 'Best Project Finance Bank in 2005 in the Middle East and Africa'.

Such independent validation of its expertise,

professionalism, innovation and market positioning is highly appreciated by GIB, and serves to strengthen the Bank's resolve to continue its contribution to the prosperity of all its stakeholders, and to the economic development of the region.



GIB continues to support the GCC's industrial sector by acting as a mandated lead arranger for the financing of many large-scale projects. In 2005, this included a US\$558.5 million term facility club deal for Qatar Steel Company.

FINANCIAL REVIEW

CONSOLIDATED NET INCOME WAS AT A HISTORICAL RECORD LEVEL IN 2005. This was the second consecutive year in which the Bank has reported a record profit. Consolidated net income after tax at US\$203.0 million for the year was US\$52.8 million or 35.2 per cent up on the prior year. This represented a return on average equity of 12.3 per cent compared to a return of 9.9 per cent in 2004.

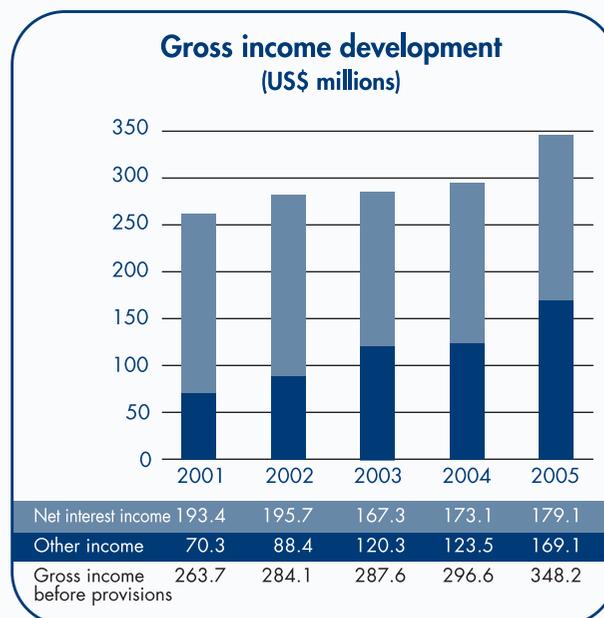
The strong performance reflected further improvements across all of the Bank's principal business activities, demonstrating the continued success of the Group's GCC-focused merchant banking strategy. The significant year-on-year increase in the Group's profit was attributable to increases in all income categories and a reduction in provisions for credit losses. An increase in interest earnings was principally due to significantly higher loan volumes and margins, related in particular to GCC project and structured financings, and a more favourable interest rate environment. GIB continues to be the leading financier and arranger of specialised lending within the GCC. Non-interest income benefited from strong fee-based income derived from the Group's strategically important merchant banking activities, including asset and fund management and corporate advisory. Operating expenses were US\$14.3 million up on the prior year. This principally reflected higher performance-related remuneration associated with the significantly stronger financial performance. As referred to in the section on operating expenses, GIB's profit per employee and cost to income ratios continue to be extremely efficient by international comparison. 2005 net income was net of a US\$2.2 million provision charge for credit losses. This compared to a

US\$23.8 million provision charge in the prior year. The significantly lower provision charge in 2005 was partly attributable to provision releases arising on the sale and settlement of impaired loans at amounts exceeding their provisioned book values. It also reflects GIB's ongoing proactive and disciplined management of risk.

NET INTEREST INCOME

Net interest income at US\$179.1 million was US\$6.0 million or 3.5 per cent up on the prior year. Net interest income is derived from the following principal sources:

- margin income on the commercial lending portfolio,
- margin income on the available-for-sale securities portfolio,
- money book activities,
- earnings on the investment of the Group's net free capital, and
- net interest earnings from the securities trading portfolio.

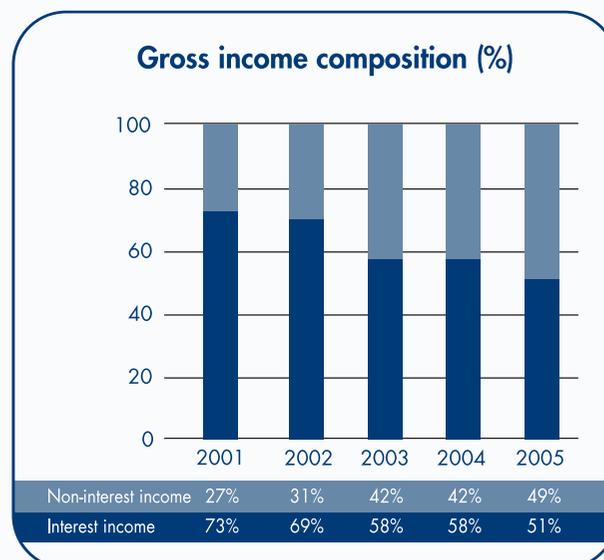


FINANCIAL REVIEW continued

Money book earnings represent the differential between the funding cost of interest-bearing assets based on internal transfer pricing methodologies and the actual funding cost incurred by the Bank. This includes benefits derived from the mismatch of the repricing profile of the Group's interest-bearing assets and liabilities. Net interest income is also reported net of the funding cost of non-interest bearing investments from which income is derived in the form of dividends and capital gains, and reported in the relevant category in other income.

Short term US interest rates continued to rise during 2005. The Federal Reserve raised interest rates seven times during the year from 2.25 per cent to 4.25 per cent at the end of 2005. The increases in interest rates impacted the Group's interest earnings in three specific respects, although had an overall positive impact on net interest income. They firstly contributed to an enhancement of the interest earnings on the investment of the Group's net free capital. The net free capital was largely uninvested during the year with the uninvested funds placed on a short term basis in the money market. This position had been adopted in early 2005 in anticipation of a rising interest rate environment, and resulted in a higher overall yield on the net free capital funds in 2005. Secondly, while the Group's money book activity continued to generate strong interest earnings in 2005, they were nevertheless 15 per cent lower than in 2004. Lastly, the higher interest rate environment also resulted in an increase in the funding cost of non-interest bearing investments.

The year-on-year increase in net interest income was also attributable to higher net interest earnings derived from the Group's commercial lending portfolio. Loan



margin income was 44 per cent up on the previous year. This reflected a significant growth in the loan portfolio during the year as well as a further improvement in margins. In particular, the volume of GCC loans grew by US\$1.6 billion or 40.9 per cent during 2005. The increase in margins was attributable to a continued focus on higher value-added, skill-based commercial banking activities, including project and structured financings and lead manager roles in syndicated facilities.

Margin income on the available-for-sale securities portfolio continued to be the largest contributor to the Group's interest earnings, accounting for 34 per cent, or more than one third, of net interest income in 2005. Margin income on available-for-sale securities nevertheless decreased in 2005 with maturing assets being replaced at lower spreads following the significant narrowing in credit spreads that has taken place over the last three years. The credit quality of the available-for-sale securities portfolio continued to be emphasised with 97.2 per cent of available-for-sale debt securities at the 2005 year end being investment grade-rated.

Trading-related interest earnings were lower than in the previous year due to the impact of the increases in interest rates on the funding cost of non-interest bearing trading instruments. This component of interest earnings is, however, relatively volatile from period to period, and is dependent on the composition of the trading portfolio.

OTHER INCOME

Other income at US\$169.1 million for the year was US\$45.6 million or 36.9 per cent up on the prior year level. An analysis of other income with prior year comparatives is set out in note 18 to the consolidated financial statements.

Dividend income of US\$46.0 million was US\$13.2 million higher than in 2004. Dividend income was principally received from investments in structured finance vehicles and externally managed funds. The year-on-year increase in dividend income largely reflected the positive impact of the higher interest rate environment on the income derived from the structured finance vehicles, the underlying investments of which are principally high quality, investment grade-rated debt securities. The funding cost of the structured finance investments is reported in net interest income. As referred to in the commentary on net interest income, the higher interest rate environment also resulted in an increase in the associated funding cost of these investments.

The Group's various trading activities, including foreign exchange, generated a US\$32.1 million profit for the year compared to a US\$30.4 million profit in 2004. Strong trading revenues were generated from emerging

market and corporate debt in particular, although material contributions were also made by the Group's trading activities in foreign exchange and equities. 2005 was characterised by strong performances across most credit-related asset classes, notably corporate and emerging market debt, despite the tight spreads prevailing during the year. Trading revenues benefited from relative value, arbitrage and non-directional trading strategies. These strategies contributed in particular to the return on emerging market debt trading significantly outperforming the EMBI Plus Index. Foreign exchange revenues benefited from strong customer-related business. This contributed to a US\$4.2 million or 64.6 per cent increase in foreign exchange profits to US\$10.7 million for the year.

Profits on available-for-sale securities amounted to US\$45.6 million for the year. This included a US\$16.7 million profit arising as a result of the active management of the investment of the Group's net free capital in fixed rate securities. The profit arose on the sale of fixed rate securities in anticipation of a rise in interest rates in the medium term. In addition, profits of US\$15.3 million were realised on the sale of shares received in previous years as part of loan restructurings. Profits were also realised on the early redemption of securities in the floating rate debt security portfolio. The portfolio is commented on in more detail in the section on available-for-sale securities.

Investment banking and management fees at US\$29.8 million were US\$6.2 million or 26.3 per cent up on the prior year. This followed year-on-year increases of 25.5 per cent, 10.6 per cent and 45.3 per cent in 2004, 2003 and

FINANCIAL REVIEW continued

2002 respectively. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory and underwriting activities. The significant year-on-year increases since 2001 reflect the Group's successful efforts in diversifying revenues through the development of a wide range of customer-related products and services. The increase in asset and fund management fees in 2005 was attributable to a higher volume of funds under management. As referred to in note 28 to the consolidated financial statements, assets held in a fiduciary capacity increased by US\$4.3 billion or 32 per cent during the year to US\$17.9 billion at 31st December 2005.

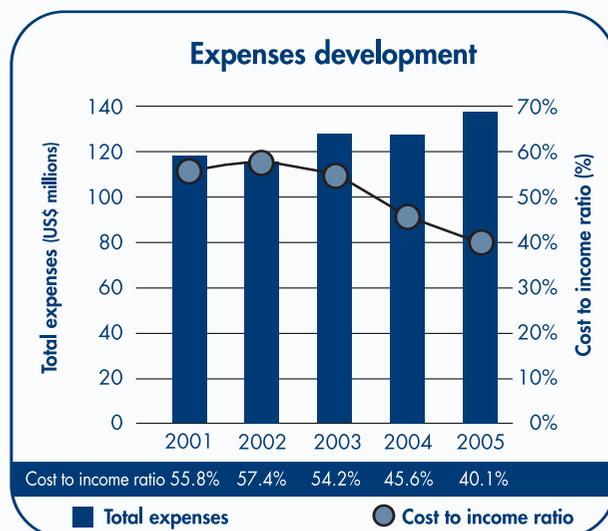
Commissions on letters of credit and guarantee at US\$12.0 million were US\$1.9 million or 18.8 per cent up on the prior year and therefore continued to make an important contribution to non-interest income. The year-on-year advance was largely attributable to an increase in guarantee commissions on GCC-related business activities. Other fee and sundry income

principally comprised loan commitment and Islamic finance arrangement fees.

OPERATING EXPENSES

Operating expenses at US\$138.7 million were US\$14.3 million up on the prior year. As explained in more detail later in this section, the year-on-year increase was recorded almost entirely in staff expenses. Despite the year-on-year increase in expenses, GIB continues to maintain one of the highest profit per employee ratios for any bank in the world in addition to an extremely low cost to income ratio. According to a survey of the top 1,000 banks in the world published by The Banker magazine in July 2005, GIB's profit per employee in 2004 was one of the highest among the top 1,000 banks ranked by Tier 1 capital. In addition, the cost to income ratio of 45.6 per cent in 2004 was significantly lower than the average ratio for each geographic region, including the U.S.A. (61.2 per cent), Europe (61.6 per cent) and Japan (74.3 per cent). In 2005, the Group's cost to income ratio decreased further to 40.1 per cent, an extremely efficient ratio by international comparison.

Staff expenses were US\$13.2 million or 14.9 per cent up on the prior year. This was attributable to higher performance-related remuneration as a result of the Group's significantly stronger performance, and higher release expenses, partly associated with a restructuring of the New York branch in order to derive further efficiencies from the relocation of back office functions to Head Office. Premises and other operating expenses were both successfully contained at much the same levels



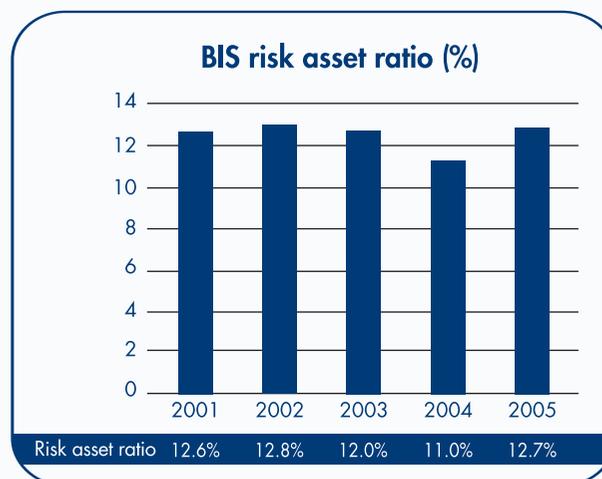
as in the previous year as a result of ongoing cost control measures.

CAPITAL STRENGTH

Total equity amounted to US\$1,718.3 million at 31st December 2005. At the 2005 year end the ratio of equity and Tier 1 capital to total assets were 7.5 per cent and 7.1 per cent respectively, ratios that are high by international comparison. The average Tier 1 capital to total assets ratio of the top 1,000 world banks was 4.53 per cent according to a survey published in The Banker magazine in July 2005.

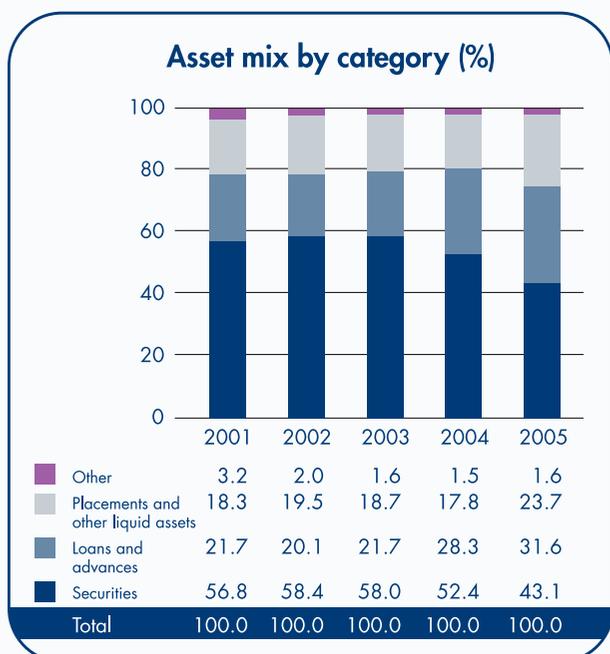
A US\$131.7 million increase in equity during 2005 comprised the net of the US\$203.0 million profit for the year, a US\$75.1 million dividend paid in respect of 2004, and a US\$3.8 million net increase in the fair value of available-for-sale securities and derivative cash flow hedges. In accordance with IAS 39, changes in the fair values of available-for-sale securities and derivative cash flow hedges are accounted for in equity.

With a total regulatory capital base of US\$2,212.6 million and total risk-weighted exposure of US\$17,476.7 million, the risk asset ratio calculated in accordance with the guidelines of the Basel Committee on Banking Supervision was 12.7 per cent. In accordance with international regulatory guidelines, the fair value adjustments to equity arising under IAS 39 in relation to available-for-sale securities and derivative cash flow hedges are excluded from the regulatory capital base, with the exception of unrealised gains and losses on equity investments. As a result, at the 2005 year end net fair value gains of US\$105.7 million were deducted from equity to



derive the regulatory capital base for capital adequacy purposes. The Bank's regulatory capital base is enhanced by subordinated term financing facilities amounting in total to US\$550.0 million. The Tier 2 capital base was enhanced during the year by a \$400 million 10 year subordinated floating rate note issued in September. GIB was the first Arab bank to issue a Tier 2 subordinated floating rate note. The subordinated term financing facilities are approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency (BMA). The risk asset ratio incorporates market risk-weighted exposure. Exposure to general market risk is calculated utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risk. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the BMA. The high proportion of equity within the total capital base resulted in a Tier 1 ratio of 9.2 per cent. Note 27 to the consolidated financial statements provides further details on capital adequacy. The risk asset ratio calculated

FINANCIAL REVIEW continued



in accordance with the guidelines of the Bank's regulatory authority, the BMA, was 15.1 per cent at the 2005 year end. Under the BMA guidelines, GCC governments and government-owned entities are accorded the same preferential risk weighting as for OECD governments. The BMA applies a minimum risk asset ratio of 12 per cent compared to a minimum of 8 per cent prescribed by the Basel Committee.

Factors which contribute to the Group's favourable capital adequacy position are the strong capital base, the level of non-specific provisions and significant exposure to major OECD country governments, including Saudi Arabia, as well as the banking sector.

ASSET QUALITY

The geographical distribution of risk assets is set out in note 21 to the consolidated financial statements. Further assessment of asset quality can be facilitated by reference

to note 30 to the consolidated financial statements on the fair value of financial instruments. Based on the valuation methodologies set out in that note, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values at 31st December 2005 by US\$1.6 million. All non-trading securities are classified as available-for-sale and measured at fair value. Available-for-sale securities are accordingly stated at fair value in the consolidated balance sheet.

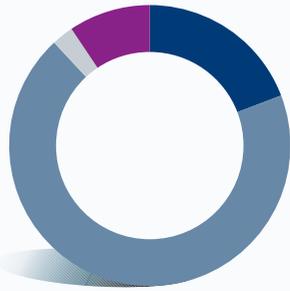
At the 2005 year end, available-for-sale securities accounted for 34.3 per cent of total assets while loans and advances represented 31.6 per cent.

Available-for-Sale Securities

Available-for-sale (AFS) securities totalled US\$7,839.6 million at 31st December 2005. The available-for-sale securities portfolio represents not only a substantial and effective liquidity reserve but also an effective international geographical diversification of the Group's risk assets with 82.6 per cent of the portfolio comprising securities of North American and European issuers. The remaining balance largely comprises securities issued by GCC country governments.

AFS securities principally comprise two types of debt security portfolios and a more limited investment in equities and equity funds, including structured finance investments. The larger debt security portfolio comprises floating rate securities or fixed rate securities that have been swapped to yield constant spreads over LIBOR. These accounted for 85.8 per cent of the total AFS securities portfolio at the 2005 year end. The smaller debt security portfolio comprises fixed income securities. This

Available-for-sale securities rating profile



	US\$ millions	%
■ AAA/Aaa rated debt securities	1,503.2	19.2
■ Debt securities of other investment grade issuers	5,402.1	68.9
■ Other debt securities	196.8	2.5
■ Equities and equity funds	737.5	9.4
Total	7,839.6	100.0

portfolio amounted to US\$374.6 million at the end of 2005. This largely comprised GCC country government bonds with original maturities of up to two years.

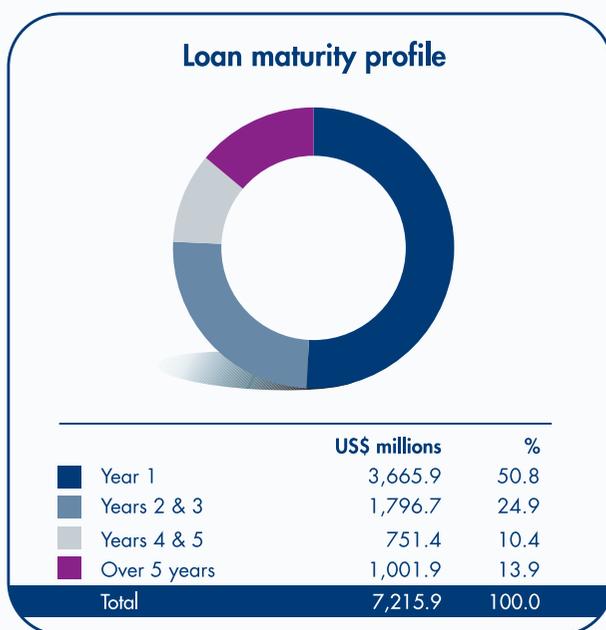
An analysis of the AFS securities portfolio by rating category is set out in note 6(a) to the consolidated financial statements. US\$1,503.2 million or 21.2 per cent of the AFS debt securities at the 2005 year end represented AAA / Aaa rated securities. Based on the rating of the issuer, a further US\$5,402.1 million or 76.0 per cent of the AFS debt securities represented other investment grade-rated securities. Thus 97.2 per cent of the total debt securities comprised investment grade-rated securities. Other debt securities, the issuers of which are rated below BBB-/ Baa3 or are unrated, amounted to US\$196.8 million at the end of 2005, thus comprising only 2.8 per cent of the total AFS debt securities portfolio. The credit risk associated with these securities is rigorously monitored within the overall credit risk management process. The securities are therefore subject to the same stringent credit requirements

as standard lending and credit-related contingent transactions. Equities and equity funds at 31st December 2005 amounted to US\$737.5 million. This principally comprised investments in the equity tranches of structured finance-related, specialised investment vehicles and, to a very limited extent, a number of private equity investments and externally managed funds providing a diversified exposure to the private equity sector. The underlying investments of the structured finance vehicles principally comprise high quality investment grade-rated floating rate debt securities. The investments generate an attractive and stable margin over LIBOR by means of the leveraged characteristics of the investment vehicles.

Loans and Advances

Loans and advances amounted to US\$7,215.9 million at the 2005 year end. This represented a US\$1,777.4 million or 32.7 per cent increase compared to the 2004 year end. The increase principally reflected further growth in the GCC loan portfolio and, in particular, project and structured finance-related facilities within the region, in line with the Group's strategic emphasis on relationship banking in the GCC. 76.6 per cent, or more than three quarters, of the loan portfolio at the 2005 year end represented lending within GIB's core market in the GCC states. Excluding trading-related advances to brokers, amounting to US\$942.2 million at the 2005 year end, 88.1 per cent of loans were to customers in the GCC. The geographical diversification of the Group's overall credit risk is achieved through the international securities markets rather than through participation in international syndicated lending transactions.

FINANCIAL REVIEW continued



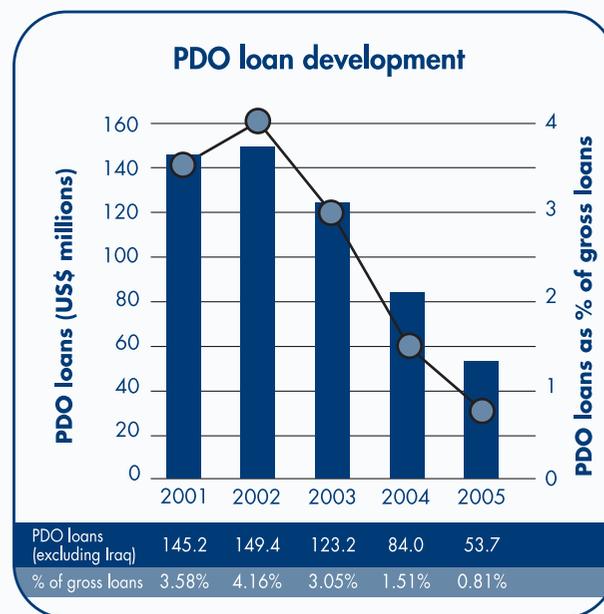
Based on contractual maturities at the balance sheet date, 50.8 per cent of the loan portfolio was due to mature within one year while 75.7 per cent was due to mature within three years. Only 13.9 per cent of loans were due to mature beyond five years. Details of exposure within the loan portfolio to GCC and OECD country governments are contained in note 7 to the consolidated financial statements while the geographical distribution of loans and advances is set out in note 21. The portfolio contained no significant concentrations by industrial sector. As discussed in note 30, the net fair value of loans and advances exceeded their net book value by US\$1.6 million.

Total loan loss provisions at 31st December 2005 amounted to US\$104.9 million. Counterparty specific provisions amounted to US\$54.9 million while non-specific provisions were US\$50.0 million. Specific provisions at the 2005 year end represented 73.8 per cent of loans against which a specific provision had been made. Specific provision utilisations during 2005 totalled

US\$2.3 million. The utilisations arose on the sale or settlement of the related loans. While loans were sold or settled at less than the nominal values, the proceeds exceeded the provisioned net book values in all cases. There was a net loan provision release of US\$11.8 million in 2005. The provision release was entirely attributable to releases arising on the sale or settlement of loans. There were no reductions in specific provisioning coverage during the year.

Specific provisions are determined based on the recoverable amount of the loan. The recoverable amount is measured as the present value of the expected future cash flows discounted based on the interest rate at the inception of the facility. Non-specific provisions are determined on a portfolio basis utilising an incurred loss model. The incurred loss model estimates the probable losses inherent within the portfolio at the balance sheet date but that have not been specifically identified. The model is based on applicable credit ratings and associated historical default probabilities, loss severity and rating migrations, and reflects the current macroeconomic, political and business environment and other pertinent indicators. Prior to 2005, provisions that were determined on a portfolio basis were collectively evaluated based on an expected loss model. The non-specific provisioning methodology was modified to an incurred loss basis in accordance with the revised version of International Accounting Standard No. 39 with effect from 1st January 2005. The effect of the change in methodology was a decrease in provisions for impairment and an increase in retained earnings of US\$51.9 million. The adjustment to provisions and retained earnings was applied retrospectively against retained earnings brought forward at 31st December 2003.

The gross and net book values of past due loans amounted to US\$53.7 million and US\$6.0 million respectively. The provisioning coverage for past due loans was therefore 88.8 per cent. Past due loans are defined as those loans for which either principal or interest is over 90 days past due. At 1st January 2005, all fully provisioned impaired loans for which principal was past due by five years or more based on original contractual maturities were transferred off-balance sheet to the memorandum records. This resulted in a decrease in past due loans and related specific provisions by US\$448.7 million. Under IAS 39, interest on impaired loans should be recognised in income based on the net book value of the loan and the interest rate that was used to discount the future cash flows for the purpose of measuring the recoverable amount. However, in accordance with guidelines issued by the Bank's regulator, the BMA, interest on past due loans is only to be recognised in income on a cash basis. In view of the Group's high provisioning coverage for impaired loans, the difference between the two bases of accounting is not material. An ageing analysis of past due loans is set out in note 7(c) to the consolidated financial statements. US\$50.9 million or 94.8 per cent of gross past due loans were overdue by more than two years. There was only one new past due loan during 2005, amounting to US\$2.8 million. The gross volume of past due loans also continued to be substantially less than total provisions. Total provisions for loan losses exceeded the gross volume of past due loans by US\$51.2 million. This means that rather than earnings being impaired by the funding cost of the net book



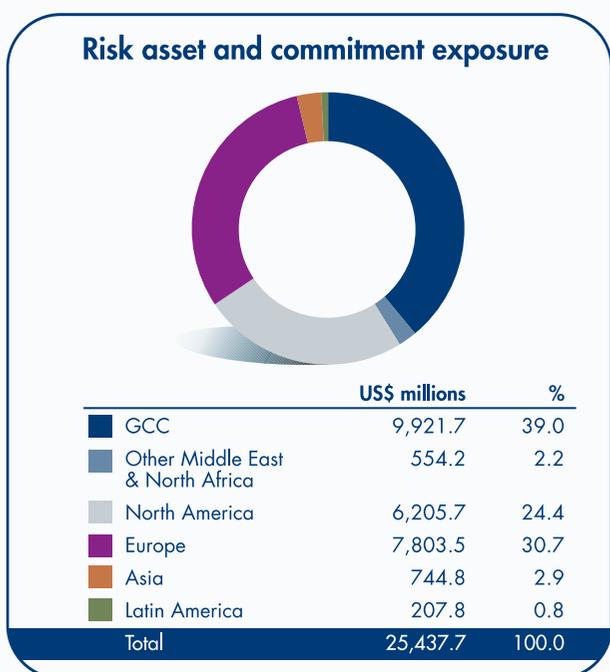
value of past due loans, there is an earnings enhancement. Past due loans at their net book value of US\$6.0 million represented less than 0.1 per cent of net loans. Past due loans at their net book value also represented only 0.3 per cent of equity.

Other Asset Categories

Cash and other liquid assets, which amounted to US\$345.4 million at the 2005 year end, are analysed in note 3 to the consolidated financial statements. In addition to cash and balances with banks, other liquid assets included certificates of deposit and Treasury bills held for balance sheet management purposes.

Placements with banks totalled US\$5,079.7 million at the 2005 year end and were well diversified by geography as illustrated in note 21 to the consolidated financial statements. Interbank placements were largely with GCC and European bank counterparties, representing the Group's two principal operating locations. Placements at

FINANCIAL REVIEW continued



the 2005 year end were at a particularly high level, reflecting the exceptionally high level of liquidity prevailing in the region. As is evident from the average balance sheet set out in note 33, placements averaged US\$4,588.4 million during the year. Placements with banks represented 22.2 per cent of total assets at the 2005 year end contributing to a very strong Liquid Assets Ratio of 66.8 per cent.

Trading securities at US\$2,007.5 million largely comprised listed debt securities amounting to US\$1,164.7 million and government bonds of US\$514.3 million. Trading securities also included US\$262.3 million of managed funds. The funds, which are managed by international institutions with acknowledged expertise in their field, provide diversified exposure to foreign exchange, hedge funds, and equity and international debt markets.

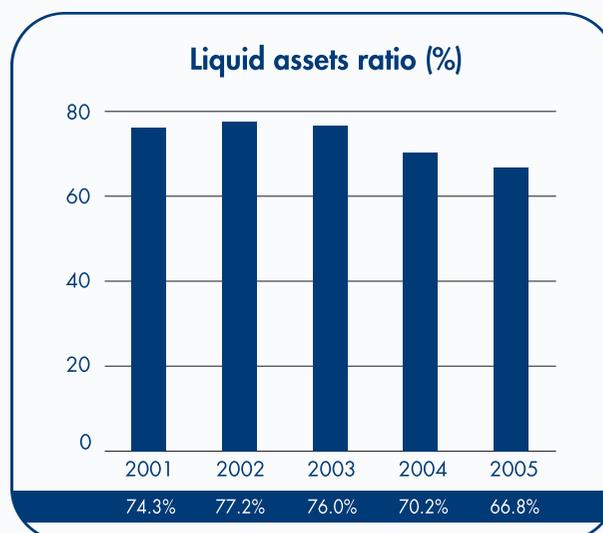
Risk Asset and Commitment Exposure

Risk asset and commitment exposure at 31st December 2005

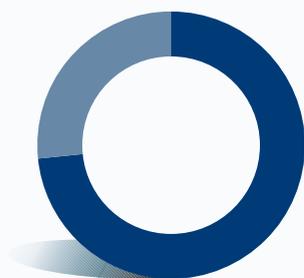
amounted to US\$25,437.7 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of other assets) and credit-related contingent items. As alluded to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 21 to the consolidated financial statements. An analysis of derivative and foreign exchange products is set out in note 24 while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 25.

FUNDING

Bank and customer deposits at 31st December 2005 totalled US\$13,462.5 million. Customer deposits amounted to US\$9,370.8 million at the 2005 year end being US\$3,202.2 million higher than at the previous year end. Customer deposits represented 69.6 per cent, or well over two thirds, of total deposits compared to 56.5 per cent at the end of 2004. The significant increase in customer deposits reflects the high level of liquidity



Deposits - geographical profile



	US\$ millions	%
GCC countries	9,884.9	73.4
Other countries	3,577.6	26.6
Total	13,462.5	100.0

within the regional market. A US\$654.5 million decrease in bank deposits compared to the 2004 year end reflected a reduced requirement for interbank funding as a result of an increase in customer deposits and term financing during the year. Funding was also enhanced by securities sold under agreements to repurchase (repos). Repos were US\$3,711.5 million at 31st December 2005. The substantial volume of investment grade rated AFS securities facilitates the Group's ability to fund through this mechanism. Repos represent a more stable and cost effective source of funding, thereby enhancing both liquidity management and profitability. As illustrated in note 10 to the consolidated financial statements, 73.4 per cent or almost three quarters of total deposits were from the GCC. GIB is a net placer of funds in the international interbank market. Term financing at 31st December 2005 totalled US\$1,944.5 million. An incremental US\$266.2 million of term financing was raised during the year as part of an ongoing programme to enhance the Group's funding profile. This included a US\$800.0 million 5 year

term deposit facility raised in the first half of the year to replace a US\$500 million term loan that matured in July. Further commentary on liquidity and funding is provided in the Risk Management Review.



In 2005, GIB was mandated as a lead arranger for various projects in Oman, including a syndicated term facility for a new petrochemical project: Aromatics Oman.

RISK MANAGEMENT REVIEW

THE GIB GROUP MAINTAINS A PRUDENT AND DISCIPLINED APPROACH TO RISK TAKING by upholding a comprehensive set of risk management policies, processes and limits, employing professionally qualified people with the appropriate skills, investing in technology and training, and actively promoting a culture of sound risk management at all levels. A key tenet of this culture is the clear segregation of duties and reporting lines between personnel transacting business and personnel processing that business. The Group's risk management is underpinned by its ability to identify, measure, aggregate and manage the different types of risks it faces.

The Board of Directors has created from among its members a Board Risk Policy Committee to review the Group's risk taking activities and report to the Board in this regard. The Board sets the overall risk parameters and tolerances within which the Group conducts its activities. The Board periodically reviews the Group's overall risk profile and significant risk exposures as well as the Group's major risk policies, processes and controls.

The Management Committee, chaired by the CEO, has the primary responsibility for sanctioning risk taking policies and activities within the tolerances defined by the Board. The Group Risk Committee assists the Management Committee to perform its risk related functions. The Group Risk Committee, comprising the Bank's most senior risk professionals, provides a forum for the review and approval of new products, risk measurement methodologies and risk control processes. The Committee also reviews all risk policies and limits that require approval by the Management Committee.

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to senior management. These functions include Risk Management, Credit Risk Control, Market Risk Control, Financial Control and Internal Audit.

This multi-faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives. Risks associated with off-balance sheet derivative instruments are managed within the overall risk management framework.

The major risks associated with the Group's business are credit, market, liquidity and operational risks. These risks and the related risk management processes are commented on in note 20 to the consolidated financial statements and are discussed in detail in the following sections.

CREDIT RISK

Credit risk is the risk that a customer, counterparty or an issuer of securities or other financial instruments fails to perform under its contractual payment obligations thus causing the Group to suffer a loss in terms of cash flow or market value. Credit risk is the predominant risk type faced by the Group in its banking, investment and treasury activities both on and off balance sheet. Where appropriate the Group seeks to minimise its credit exposure using a variety of techniques including but not limited to the following:

- entering netting agreements with counterparties that permit offsetting of receivables and payables,
- obtaining collateral against the Group's exposure,
- seeking third party guarantees of the counterparty's obligations,
- imposing restrictions and covenants on borrowers.

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each exposure, which affects the credit approval decision and the terms and conditions of the transaction. For cross

RISK MANAGEMENT REVIEW continued

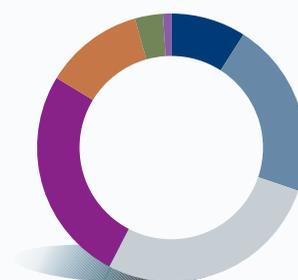
border transactions an analysis of country risk is also conducted. The Group bases its credit decision for an individual counterparty on the aggregate Group exposure to that counterparty and all its related entities. Groupwide credit limit setting and approval authorisation requirements are conducted within Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Groupwide basis in a consistent manner.

Overall exposures are evaluated to ensure broad diversification of credit risk. Potential concentration risks by product, industry, single obligor, credit risk rating and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by the Chief Credit Officer and other members of senior management. In general, all credit exposures are reviewed at least once a year. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review.

The credit risk associated with foreign exchange and derivative instruments is assessed in a manner similar to that associated with on-balance sheet activities. The Group utilises derivative transactions for proprietary trading, to facilitate customer transactions and for the management of interest and foreign exchange risks associated with the Group's longer-term lending, borrowing and investment activities. Unlike on-balance sheet products, where the principal amount and interest generally represent the maximum credit exposure, the notional amount relating to a foreign exchange or derivative transaction typically exceeds the credit exposure by a substantial margin. The measure of credit exposure for foreign exchange and derivative instruments is therefore more appropriately considered to be the replacement cost at current market rates plus an add-on amount commensurate with the position's size, volatility and remaining life.

Derivative contracts may also carry legal risk; the

Credit risk rating profile
as at 31st December 2005



	US\$ millions	%
AAA/Aaa	2,336.3	9.2
AA/Aa	5,429.4	21.3
A/A	7,015.2	27.6
BBB/Baa	6,663.9	26.2
BB/Ba	3,048.4	12.0
B/B	871.9	3.4
Below B/B	72.6	0.3
Total	25,437.7	100.0

Group seeks to minimise these risks by the use of standard contract agreements. The current gross positive market values or credit risk amounts of foreign exchange and derivative transactions are set out in note 24 to the consolidated financial statements. The total credit risk amount in respect of all such transactions outstanding at the 2005 year end amounted to US\$49.8 million before taking account of the risk-reducing benefits of any collateral held or legally enforceable netting agreements. Transactions maturing beyond one year represented either hedging transactions entered into for asset and liability management purposes or fully offset customer transactions. The aggregate credit facilities rescheduled during the year were not material. Further, such rescheduled exposures had no significant impact on provisions.

MARKET RISK

Market risk is the risk of loss of value of a financial instrument or a portfolio of financial instruments as a result of changes in market prices and rates. Market risk arises

from the Group's trading, asset and liability management and investment activities. A description of the categories of market risk faced by the Group is set out below:

- Interest rate risk results from exposure to changes in the level, slope, curvature and volatility of interest rates and credit spreads. The credit spread risk is the risk that the interest yield for a security will increase, with a reduction in the security price, relative to benchmark yields as a result of the general market movements for that rating and class of security. Interest rate risk is the principal type of market risk faced by the Group and arises from the Group's investment activities in debt securities, asset and liability management and the trading of debt and off-balance sheet derivative instruments.
- Foreign exchange risk results from exposure to changes in the price and volatility of currency spot and forward rates. For the Group, the principal foreign exchange risk arises from its investments in externally managed currency funds and from its foreign exchange forward and derivatives trading activities.
- Equity risk arises from exposures to changes in the price and volatility of individual equities or equity indices. The Group's equity risk principally arises from its trading activities in US and European equities, equity derivatives and convertibles.
- Commodity risk results from exposure to changes in the price and volatility of commodities. The Group's commodity risk arises entirely from its derivative trading activities.

The Group seeks to manage the market risks it faces through diversification of exposures across dissimilar markets and establishment of hedges in related securities or off balance sheet derivative instruments. To manage the Group's exposures in addition to the exercise of business judgment and management experience, the Group utilises

limit structures including those relating to positions, portfolios, maturities and maximum allowable losses.

A key element in the Group's market risk management framework is the estimation of potential future losses that may arise from adverse market movements. The Group utilises Value-at-Risk (VaR) to estimate such losses. The Group's VaR is calculated on a variance/co-variance basis using exponentially weighted one-year historical daily movements in market rates and prices, giving greater importance to the more recent observations in estimating potential future losses. The VaR takes account of potential diversification benefits of different positions both within and across different portfolios. Consistent with general market practice, VaR is computed for all financial instruments for which there are readily available daily prices or a suitable proxy.

VaR is viewed as an effective risk management tool and a valuable addition to the non-statistically based limit structure. It permits a consistent and uniform measure of market risk across all applicable products and activities. Exposures are monitored against a range of limits both by risk category and portfolio and are regularly reported to and reviewed by senior management and the Board of Directors.

For internal risk management purposes, the Group measures losses that are anticipated to occur within a 95 per cent confidence level. This implies that there is on average a 5 per cent or a 1 in 20 chance of a loss exceeding the VaR over the prescribed time horizon or holding period. The Group measures VaR utilising a one month assumed holding period for both trading and available-for-sale positions.

The graph on the following page sets out the total Value-at-Risk for all the Group's trading activities at the close of each business day throughout the year. The figures are calculated using the regulatory VaR basis at a 1 per cent risk level (2.33 standard deviations) and at the ten-day horizon using one-year unweighted historical daily movements in market rates and prices. On this basis, total

RISK MANAGEMENT REVIEW continued

diversified VaR over the year averaged US\$6.3 million and varied within the range of US\$5.0 million to US\$7.5 million with a 2005 year-end value of US\$6.4 million.

The Group conducts daily VaR back testing both for regulatory compliance with the Basel Committee on Banking Supervision market risk capital rules and for internal evaluation of VaR against trading profits and losses. During 2005, there was only one occasion on which a daily trading loss exceeded the trading VaR at the close of business on the previous business day. The Basel Committee's guidelines on back testing permit a maximum of five excesses beyond which the multiplication factor determined by the regulator may be increased.

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (i.e. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are designed to estimate the potential economic losses in such abnormal markets. Therefore, stress testing combined with VaR

provides a more comprehensive picture of market risk. The Group regularly performs stress tests that are constructed around changes in market rates and prices resulting from pre-defined market stress scenarios, including both historical and hypothetical market events. Historical scenarios include the 1997 Asian crisis, the 1998 Russian crisis and the Summer 2002 corporate scandals. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability repricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile and details of the effective interest rates prevailing at the year end on the various asset and liability categories are set out in note 23 to the consolidated financial statements. As illustrated in note 23, the substantial majority of assets and liabilities



reprice within one year. Interest rate exposure beyond one year amounted to only US\$459 million or 2.0 per cent of total assets. This exposure represented the investment of the net free capital funds in fixed rate government securities and fixed receive interest rate swaps. At 31st December 2005 the modified duration of these fixed rate government securities and interest rate swaps was 3.8.

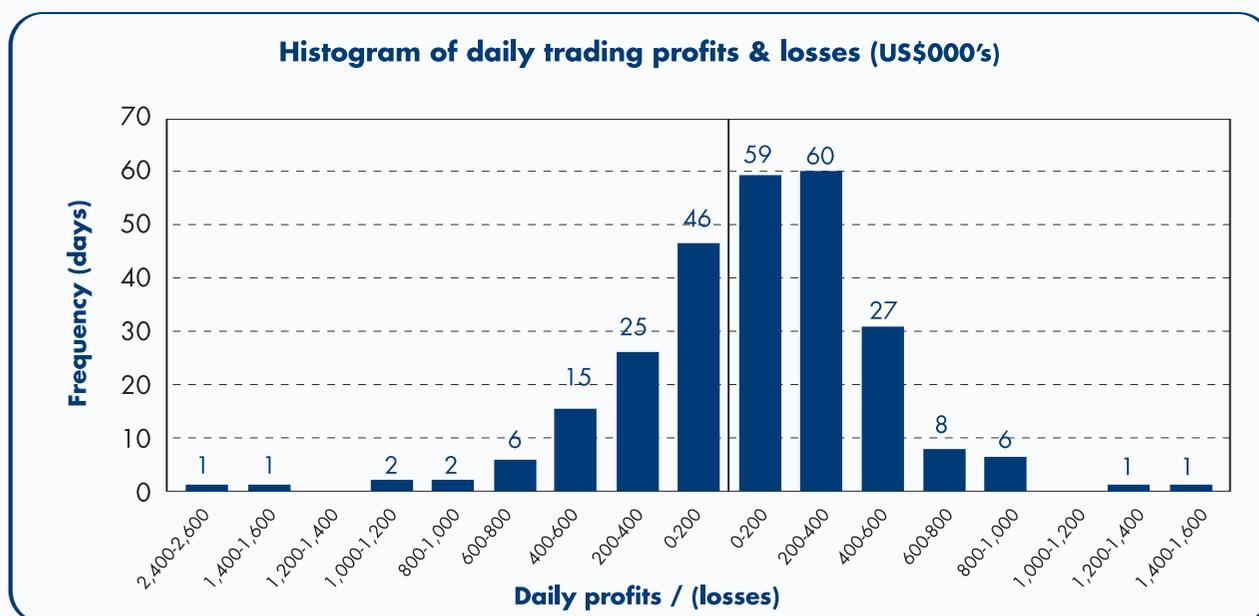
OPERATIONAL RISK

Operational risk is the risk of loss arising from inadequate or failed internal processes, people and systems or from external events, whether intentional, unintentional or natural. It is an inherent risk faced by all businesses and covers a large number of operational risk events including business interruption and systems failures, internal and external fraud, employment practices and workplace safety, customer and business practices, transaction execution and process management, and damage to physical assets.

Whilst operational risk cannot be eliminated in its entirety, the Group endeavours to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation.

The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the procedures, as applicable.

The Group's Operational Risk Management Framework (ORMF), in line with Basel II requirements, is well under way and a team has been assigned to implement and manage the framework. As part of the ORMF, a comprehensive risk self-assessment exercise was conducted, which identified the operational risks inherent in the Group's activities, processes and systems. The controls in place to mitigate these risks were also reviewed, and enhanced as necessary. A database of measurable operational losses is maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk. Management reporting of the ORMF is currently being developed.





GIB confirmed its status within Europe as a leading manager of mezzanine ABS products, through the issue of a fourth CDO in 2005, a Euro 305.6 million FAB CBO backed by a portfolio of senior, mezzanine and junior asset-backed and synthetic securities.

FINANCIAL STATEMENTS

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REPORT OF THE AUDITORS TO THE SHAREHOLDERS

We have audited the consolidated financial statements of Gulf International Bank B.S.C. (the Bank) and its subsidiaries (the Group) as at, and for the year ended, 31st December 2005 as set out on pages 37 to 71.

Respective responsibilities of Directors and Auditors

These financial statements are the responsibility of the Board of Directors of the Bank. Our responsibility is to express an opinion on these financial statements based on our audit.

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31st December 2005, the results of its operations, changes in the equity and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

Other regulatory matters

In addition, in our opinion, the Group has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying Chairman's Statement and confirm that the information contained therein is consistent with the consolidated financial statements. To the best of our knowledge and belief, no violations of the Bahrain Commercial Companies Law 2001 or the Bahrain Monetary Agency Law, 1973 (as amended) or the terms of the Bank's licence, or its Agreement of Establishment, or its Articles of Association have occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.



KPMG
Public Accountants
Manama, Kingdom of Bahrain
19th February 2006

CONSOLIDATED BALANCE SHEET

	Note	At 31.12.05 US\$ millions	At 31.12.04 US\$ millions
Assets			
Cash and other liquid assets	3	345.4	144.6
Placements with banks	4	5,079.7	3,286.5
Trading securities	5	2,007.5	1,612.4
Available-for-sale securities	6	7,839.6	8,469.1
Loans and advances	7	7,215.9	5,438.5
Other assets	8	368.5	287.9
Total assets		22,856.6	19,239.0
Liabilities			
Deposits from banks	10	4,091.7	4,746.2
Deposits from customers	10	9,370.8	6,168.6
Securities sold under agreements to repurchase	11	3,711.5	3,818.8
Securities sold but not yet purchased		873.5	564.9
Other liabilities	12	596.3	525.6
Term financing	13	1,944.5	1,678.3
Subordinated term financing	14	550.0	150.0
Total liabilities		21,138.3	17,652.4
Equity			
Share capital	15	1,000.0	1,000.0
Share premium		7.6	7.6
Reserves	16	334.6	289.8
Retained earnings		376.1	289.2
Total equity		1,718.3	1,586.6
Total liabilities & equity		22,856.6	19,239.0

The consolidated financial statements were approved by the Board of Directors on 19th February 2006 and signed on their behalf by:-

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 41 to 71 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

	Note	Year ended 31.12.05 US\$ millions	Year ended 31.12.04 US\$ millions
Interest revenue			
Interest on securities		355.8	255.1
Interest and fees on loans		255.1	122.0
Interest on placements and other liquid assets		176.4	80.5
		<u>787.3</u>	<u>457.6</u>
Interest expense			
Net interest income		608.2	284.5
Provisions for securities	6	14.0	5.2
Provisions for loans and advances	7	(11.8)	18.6
Net interest income after provisions		<u>176.9</u>	<u>149.3</u>
Other income			
Net interest and other income	18	<u>169.1</u>	<u>123.5</u>
Operating expenses			
Staff		101.7	88.5
Premises		7.6	6.9
Other		29.4	29.0
		<u>138.7</u>	<u>124.4</u>
Net income before tax		207.3	148.4
Taxation charge / (credit) on overseas activities		4.3	(1.8)
Net income after tax		<u>203.0</u>	<u>150.2</u>
Earnings per share	31	<u>US\$0.20</u>	<u>US\$0.15</u>

The notes on pages 41 to 71 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended 31.12.05 US\$ millions	Year ended 31.12.04 US\$ millions
Operating activities		
Net income after tax	203.0	150.2
Adjustments to reconcile net income to net cash (outflow) / inflow from operating activities:		
Provisions for securities	14.0	5.2
Provisions for loans and advances	(11.8)	18.6
Profit on available-for-sale securities	(45.6)	(23.2)
Amortisation of available-for-sale securities	1.7	1.1
Increase in accrued interest receivable	(87.2)	(28.0)
Increase in accrued interest payable	65.5	17.6
Decrease / (increase) in other net assets	90.8	(96.2)
Net increase in trading securities	(395.1)	(28.8)
Net cash (outflow) / inflow from operating activities	(164.7)	16.5
Investing activities		
Net increase in placements with banks	(1,793.2)	(263.4)
Net increase in loans and advances	(1,765.6)	(1,545.3)
Purchase of available-for-sale securities	(1,503.0)	(1,421.5)
Sale and maturity of available-for-sale securities	2,087.2	1,439.0
Net cash outflow from investing activities	(2,974.6)	(1,791.2)
Financing activities		
Net decrease in deposits from banks	(654.5)	(683.7)
Net increase in deposits from customers	3,202.2	1,158.1
Net (decrease) / increase in securities sold under agreements to repurchase	(107.3)	812.3
Net increase in securities sold but not yet purchased	308.6	293.7
Net increase in term financing	266.2	177.0
Net increase in subordinated term financing	400.0	-
Dividends paid	(75.1)	(53.1)
Net cash inflow from financing activities	3,340.1	1,704.3
Increase / (decrease) in cash and cash equivalents	200.8	(70.4)
Cash and cash equivalents at 1 st January	144.6	215.0
Cash and cash equivalents at 31 st December	345.4	144.6

The notes on pages 41 to 71 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital US\$ millions	Share premium US\$ millions	Reserves US\$ millions	Retained earnings US\$ millions	Total equity US\$ millions
At 31 st December 2003 as previously reported	1,000.0	7.6	226.8	154.4	1,388.8
Effect of adopting IAS 39 (revised):-					
- Transfer of net fair value loss on available-for-sale securities from retained earnings to reserves	-	-	(15.8)	15.8	-
- Transfer to retained earnings arising on the modification of the methodology for determining non-specific loan provisions	-	-	-	51.9	51.9
Opening balances restated	1,000.0	7.6	211.0	222.1	1,440.7
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	56.9	-	56.9
- Cash flow hedges: net fair value losses	-	-	(0.1)	-	(0.1)
Transfers in the year:-					
- Transfers to net income	-	-	(8.0)	-	(8.0)
Net gains recognised directly in equity	-	-	48.8	-	48.8
Dividend for 2003	-	-	-	(53.1)	(53.1)
Net income for the year	-	-	-	150.2	150.2
Transfers from retained earnings	-	-	30.0	(30.0)	-
At 31 st December 2004	1,000.0	7.6	289.8	289.2	1,586.6
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	15.0	-	15.0
- Cash flow hedges: net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(8.2)	-	(8.2)
Net gains recognised directly in equity	-	-	3.8	-	3.8
Dividend for 2004	-	-	-	(75.1)	(75.1)
Net income for the year	-	-	-	203.0	203.0
Transfers from retained earnings	-	-	41.0	(41.0)	-
At 31 st December 2005	1,000.0	7.6	334.6	376.1	1,718.3

The notes on pages 41 to 71 form part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

1. INCORPORATION AND REGISTRATION

The parent company of the Group (the Group), Gulf International Bank B.S.C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No. 30 dated 24th November 1975 and is registered as an offshore banking unit with the Bahrain Monetary Agency. The registered office of the Bank is located at Al-Dowali Building, 3 Palace Avenue, Manama, Kingdom of Bahrain.

The Group is principally engaged in the provision of wholesale commercial and investment banking services. The Group operates through subsidiaries, branch offices and representative offices located in six countries worldwide. The total number of staff employed by the Group at the end of the financial year was 567.

2. ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of the consolidated financial statements are set out below:-

2.1 Basis of presentation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and in conformity with the Bahrain Commercial Companies Law and the Bahrain Monetary Agency Law. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, available-for-sale securities and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year except for changes resulting from amendments to International Accounting Standard (IAS) No. 39 - Financial Instruments: Recognition and Measurement, as described in more detail below.

The amendments to IAS 39, which became effective on 1st January 2005, resulted in a modification of the methodology for determining provisions for impairment. The amendments to IAS 39 also resulted in the reclassification of unrealised gains and losses arising from changes in the fair values of available-for-sale securities previously accounted for in retained earnings on the adoption of the original IAS 39 on 1st January 2001. In accordance with the revised version of IAS 39, all unrealised gains and losses arising from changes in the fair values of available-for-sale securities are to be recognised in a separate revaluation reserve. The unrealised fair value gains and losses previously accounted for in retained earnings have accordingly been transferred to the separate revaluation reserve in equity. These changes were applied retrospectively in accordance with the requirements of IAS No. 8 - Accounting Policies, Changes in Accounting Estimates and Errors, to ensure they are applied within each period presented.

Prior to the adoption of the revised version of IAS 39, provisions for impairment that were measured and recognised on a portfolio basis were collectively evaluated for impairment based on an expected loss model. Under the revised IAS 39, these credit exposures are collectively evaluated for impairment based on an incurred loss model. The incurred loss model estimates the probable losses inherent within the portfolio at the balance sheet date but that have not been specifically identified. The estimates are based on external and internal risk ratings, historical default rates, loss severity and rating migrations, and reflect the macroeconomic, political and business environment and other pertinent factors.

The financial effects of adopting the revised version of IAS 39 are reported in the consolidated statement of changes in equity and in note 7 to the consolidated financial statements. In addition, where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year as required by the revised IAS 39. The adoption of the revised IAS 39 had no impact on the Group's consolidated net income for the twelve months ended 31st December 2004.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

2. ACCOUNTING POLICIES (continued)

2.2 Consolidation principles

The consolidated financial statements include the accounts of Gulf International Bank B.S.C. and its subsidiaries. Subsidiary undertakings are companies and other entities, including special purpose entities, in which the Bank holds, directly or indirectly, more than one half of the voting rights, or otherwise has the power to exercise effective control over the financial and operating policies of the entity. All intercompany balances and transactions, including unrealised gains and losses on transactions between Group companies, have been eliminated.

2.3 Use of estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of financial assets and liabilities at the balance sheet date. The use of estimates and assumptions is principally limited to the determination of impairment provisions for loans and available-for-sale securities, and the valuation of the Group's defined benefit pension plan. The estimates and assumptions relating to provisions for impairment are described in more detail in note 2.12 to the consolidated financial statements. The principal actuarial assumptions for the defined benefit pension plan are set out in note 9 to the consolidated financial statements.

2.4 Trade and settlement date accounting

All regular way purchases and sales of financial assets held for trading are recognised on the trade date, i.e. the date on which the Group commits to purchase or sell the financial asset. All regular way purchases and sales of other financial assets are recognised on the settlement date, i.e. the date on which the asset is delivered to or received from the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the time frame generally established by regulation or convention in the market place.

2.5 Foreign currencies

Items included in the financial statements of the Bank and its principal subsidiaries are measured based on the currency of the primary environment in which the entity operates (the functional currency). The consolidated financial statements are presented in US Dollars, representing the Bank's functional and presentation currency. Transactions in foreign currencies are converted to US Dollars at the rate of exchange prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into US Dollars at market rates of exchange prevailing at the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in other income.

2.6 Offsetting

Financial assets and liabilities are only offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.

2.7 Derivative financial instruments

Derivative financial instruments are contracts, the value of which is derived from one or more underlying financial instruments or indices, and include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and commodity markets.

Derivative financial instruments are recognised in the consolidated balance sheet at fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate. In the consolidated balance sheet, derivative financial instruments with positive fair values (unrealised gains) are included in other assets and derivative financial instruments with negative fair values (unrealised losses) are included in other liabilities.

The changes in the fair values of derivative financial instruments entered into for trading purposes or to hedge other trading positions are included in other income in the consolidated statement of income.

2. ACCOUNTING POLICIES (continued)

2.7 Derivative financial instruments (continued)

The recognition of changes in the fair values of derivative financial instruments entered into for hedging purposes is determined by the nature of the hedging relationship. For the purposes of hedge accounting, derivative financial instruments are designated as a hedge of either: (i) the fair value of a recognised asset or liability (fair value hedge), or (ii) the future cash flows attributable to a recognised asset or liability or a firm commitment (cash flow hedge).

The Group's criteria for a derivative financial instrument to be accounted for as a hedge include:-

- the hedging instrument, the related hedged item, the nature of the risk being hedged, and the risk management objective and strategy must be formally documented at the inception of the hedge,
- it must be clearly demonstrated that the hedge is expected to be highly effective in offsetting the changes in fair values or cash flows attributable to the hedged risk in the hedged item,
- the effectiveness of the hedge must be capable of being reliably measured, and
- the hedge must be assessed on an ongoing basis and determined to have actually been highly effective throughout the financial reporting period.

Changes in the fair values of derivative financial instruments that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in other income in the consolidated statement of income together with the corresponding change in the fair value of the hedged asset or liability that is attributable to the risk that is being hedged. Unrealised gains and losses arising on hedged assets or liabilities which are attributable to the hedged risk are adjusted against the carrying amounts of the hedged assets or liabilities in the consolidated balance sheet. If the hedge no longer meets the criteria for hedge accounting, any adjustment to the carrying amount of a hedged interest-bearing financial instrument is amortised to income over the remaining period to maturity.

Changes in the fair values of derivative financial instruments that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk, are recognised in a separate component of equity. Unrealised gains or losses recognised in equity are transferred to the consolidated statement of income at the same time that the income or expense of the corresponding hedged item is recognised in the income statement and are included in the same income or expense category as the hedged item. Unrealised gains or losses on any ineffective portion of cash flow hedging transactions are recognised in other income in the consolidated statement of income.

The interest component of derivatives that are designated, and qualify, as fair value or cash flow hedges is recognised in interest income or interest expense over the life of the derivative instrument.

Certain derivative transactions, while providing effective economic hedges within the Group's risk management positions, do not qualify for hedge accounting under the specific rules in IAS 39. Such derivative transactions are categorised as derivatives held for trading and related fair value gains and losses included in other income in the consolidated statement of income.

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting.

2.8 Interest income and expense

Interest income and interest expense are recognised for all interest-bearing financial instruments on an accruals basis using the effective yield method based on the original settlement amount. Loan origination fees are deferred and recognised as an adjustment to the effective yield on the loan. Interest income is suspended when interest or principal on a credit facility is overdue by more than 90 days whereupon all unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities are restored to accrual status only after all delinquent interest and principal payments have been brought current and future payments are reasonably assured.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

2. ACCOUNTING POLICIES (continued)

2.9 Securities financing arrangements

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralised lending and borrowing transactions and are recorded in the consolidated balance sheet at the amounts the securities were initially acquired or sold. Interest earned on reverse repurchase agreements and interest incurred on repurchase agreements are included in interest income and interest expense respectively. Securities purchased under agreements to resell are included in cash and other liquid assets.

2.10 Securities

Trading securities are securities which are either acquired for the purpose of generating a profit from short-term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists. Trading securities are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on quoted market prices. Realised and unrealised gains and losses are included in other income. Interest earned on trading securities and interest incurred on securities sold but not yet purchased are included in interest income and interest expense respectively.

Available-for-sale securities are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration. Available-for-sale securities are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on quoted market prices or amounts derived from cash flow models as appropriate. Unquoted and illiquid equity investments for which fair values cannot be reliably measured are stated at cost less provision for impairment. Unrealised gains and losses arising from changes in the fair values of available-for-sale securities are recognised in a separate revaluation reserve in equity. The cumulative fair value adjustments on available-for-sale securities which are sold or otherwise disposed of, or become impaired, and which had previously been recognised in equity are transferred to the consolidated statement of income.

Dividends received on trading and available-for-sale securities are included in other income.

2.11 Loans and advances

Loans which are acquired for the purpose of generating a profit in the short term are categorised as held-for-trading assets. Loans categorised as held-for-trading are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on available market prices. Realised and unrealised gains and losses are included in other income. Interest earned on trading loans is included in interest income. All other loans are stated at amortised cost less provision for impairment.

Loans are written off after all restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote. Subsequent recoveries are included in other income.

2.12 Provisions for impairment

A provision for impairment is established where there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the credit facility. The provision for impairment is determined based on the difference between the net carrying amount and the recoverable amount of the financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted based on the interest rate at the inception of the credit facility or, for debt instruments remeasured to fair value, at the current market rate of interest for a similar financial asset.

Provisions for impairment are also measured and recognised on a portfolio basis where there is objective evidence that probable losses are present in groups of similar credit exposures. These exposures are collectively evaluated for impairment with the provisions for incurred losses based on the applicable external and internal risk ratings and associated historical default rates, loss severity and rating migrations, and reflect the macroeconomic, political and business environment and other pertinent indicators.

2. ACCOUNTING POLICIES (continued)

2.12 Provisions for impairment (continued)

With the exception of provisions for the impairment of investments in equity instruments classified as available-for-sale, provisions for impairment are released and transferred to the consolidated statement of income where a subsequent increase in the recoverable amount is related objectively to an event occurring after the provision for impairment was established. Impairment losses for available-for-sale equity investments are only released and transferred to the consolidated statement of income on the redemption or sale of the investment.

2.13 Other provisions

Other provisions are recognised when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

2.14 Premises and equipment

Land is stated at cost. Other fixed assets are stated at cost less accumulated depreciation. The residual values and useful lives of fixed assets are reviewed at each balance sheet date, and adjusted where appropriate. Where the carrying amount of a fixed asset is greater than its estimated recoverable amount, the carrying amount is reduced to the recoverable amount.

Generally, costs associated with the maintenance of existing computer software are recognised as an expense when incurred. However, expenditure that enhances and extends the benefits of computer software programs beyond their original specifications and lives is recognised as a capital improvement and capitalised as part of the original cost of the software.

2.15 Post retirement benefits

The majority of the Group's employees are eligible for post retirement benefits under either defined benefit or defined contribution pension plans which are provided through separate trustee-administered funds or insurance plans. The Group also pays contributions to Government defined contribution pension plans in accordance with the legal requirements in each location.

The Group's contributions to defined contribution pension plans are charged to income in the year to which they relate.

The pension costs for defined benefit pension plans are assessed using the projected unit credit method. The cost of providing pensions is charged to income so as to spread the regular cost of pensions over the service lives of the employees, in accordance with the advice of an independent qualified actuary who conducts a full valuation of the plan every three years. The pension obligation is measured as the present value of the estimated future cash flows using interest rates of government securities which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised in income over the average remaining service lives of employees.

2.16 Deferred income taxes

Deferred income taxes are provided, using the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the unused tax losses and credits can be utilised. Currently enacted tax rates are used to determine deferred income taxes.

2.17 Cash and cash equivalents

For the purposes of the consolidated statement of cash flows, cash and cash equivalents comprise cash and other liquid assets.

2.18 Segment reporting

A segment is a distinguishable component of the Group that is engaged in providing products or services (business segment) or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments. Segments whose revenue, result or assets comprise 10 per cent or more of the total for all segments are reported separately.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

2. ACCOUNTING POLICIES (continued)

2.19 Fiduciary activities

The Group administers and manages assets owned by clients which are not reflected in the consolidated financial statements. Asset management fees are earned for providing investment management services and for managing mutual fund products. Asset administration fees are earned for providing custodial services. Fees are recognised as the services are provided and are included in other income.

2.20 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

3. CASH AND OTHER LIQUID ASSETS

	31.12.05 US\$ millions	31.12.04 US\$ millions
Cash and balances with banks	82.6	63.0
Certificates of deposit	233.4	57.0
Securities purchased under agreements to resell	28.8	11.3
Treasury bills	0.6	13.3
	<u>345.4</u>	<u>144.6</u>

Certificates of deposit and treasury bills are categorised as assets held-to-maturity and are stated at amortised cost.

4. PLACEMENTS WITH BANKS

Placements with banks are categorised as assets held-to-maturity and are stated at cost.

Placements with banks at 31st December 2005 included placements with non-bank financial institutions amounting to US\$171.6 million (2004: US\$193.8 million).

5. TRADING SECURITIES

	31.12.05 US\$ millions	31.12.04 US\$ millions
Government bonds	514.3	315.6
Listed debt securities	1,164.7	974.0
Unlisted debt securities	8.1	6.8
Managed funds	262.3	247.1
Equities	58.1	68.9
	<u>2,007.5</u>	<u>1,612.4</u>

Managed funds represent funds placed for investment with external asset managers. The funds provide a diversified exposure to foreign exchange, equity and international debt markets.

6. AVAILABLE-FOR-SALE SECURITIES

a) Classification of available-for-sale securities

	31.12.05 US\$ millions	31.12.04 US\$ millions
AAA/Aaa rated debt securities	1,503.2	1,459.2
Debt securities of other investment grade issuers	5,402.1	6,218.4
Other debt securities	196.8	186.0
Equities and equity funds	737.5	605.5
	7,839.6	8,469.1

The Group's available-for-sale securities predominantly comprise higher quality, investment grade-rated debt securities. At 31st December 2005, 97.2 per cent of available-for-sale debt securities were investment grade-rated (2004: 97.6 per cent).

Equities and equity funds principally comprise investments of a structured finance nature managed by international investment banks, the underlying investments of which are high quality, investment-grade rated debt securities.

Debt securities of other investment grade issuers at 31st December 2005 included GCC country government securities of US\$538.5 million (2004: US\$913.9 million).

b) Provisions for impairment

The movements in the provisions for the impairment of available-for-sale securities were as follows:-

	2005 US\$ millions	2004 US\$ millions
At 1 st January	90.7	92.2
Exchange rate movements	(3.4)	1.8
Amounts utilised	(29.7)	(8.5)
Charge for the year	14.0	5.2
At 31 st December	71.6	90.7

c) Unquoted equity investments

Available-for-sale securities at 31st December 2005 included US\$50.5 million (2004: US\$54.2 million) of unquoted equity investments for which fair values cannot be reliably measured. These investments are stated at cost less provision for impairment. They principally comprise investments in managed entities, the underlying investments of which are primarily of either a corporate debt or private equity nature, managed by external specialist managers and international investment banks. There are no active markets or other appropriate methods from which to derive reliable fair values for these investments.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

7. LOANS AND ADVANCES

	31.12.05 US\$ millions	31.12.04 US\$ millions
Loans	6,378.6	5,416.7
Advances to brokers	942.2	591.4
Gross loans and advances	7,320.8	6,008.1
Provisions for impairment	(104.9)	(569.6)
Net loans and advances	7,215.9	5,438.5

a) Concentrations of loans and advances

Net loans and advances at 31st December 2005 included exposure to GCC country governments of US\$265.3 million (2004: US\$183.1 million) and OECD country central government and agency risk of US\$76.1 million (2004: US\$88.3 million).

There were no significant concentrations by industrial sector at either 31st December 2005 or at 31st December 2004.

b) Provisions for impairment

The movements in the provisions for the impairment of loans and advances were as follows:-

	2005 US\$ millions	2004 US\$ millions
At 1 st January	569.6	569.3
Decrease arising on the transfer of impaired loans off-balance sheet	(448.7)	-
Exchange rate movements	(1.9)	10.2
Amounts utilised	(2.3)	(28.5)
(Release) / charge for the year	(11.8)	18.6
At 31 st December	104.9	569.6

Total specific provisions at 31st December 2005 represented 73.8 per cent (2004: 90.2 per cent) of loans against which a specific provision had been made. Total provisions at 31st December 2005 exceeded the gross book value of past due loans by US\$51.2 million (2004: US\$36.9 million).

Prior to the adoption of the revised version of IAS 39 with effect from 1st January 2005, provisions for impairment that were measured and recognised on a portfolio basis were collectively evaluated for impairment based on an expected loss model. Following the adoption of the revised IAS 39, such provisions are collectively evaluated for impairment based on an incurred loss model. The incurred loss model estimates the probable losses inherent within the portfolio at the balance sheet date but that have not been specifically identified. The effect of modifying the methodology for determining non-specific provisions on the adoption of the revised IAS 39 was a decrease in provisions for impairment and an increase in retained earnings at 31st December 2003 of US\$51.9 million. The adjustment to retained earnings is reported in the consolidated statement of changes in equity.

At 1st January 2005, fully provisioned impaired loans for which principal was past due by five years or more based on original contractual maturities were transferred off-balance sheet to the memorandum records. This resulted in a decrease in related specific provisions of US\$448.7 million. The transfer of the impaired loans to the memorandum records had no impact on the net book value of loans reported in the consolidated balance sheet.

At 31st December 2005 there was no accrued but uncollected interest on impaired loans included in interest income (2004: nil)

7. LOANS AND ADVANCES (continued)

c) Past due loans

The gross and net book value of loans for which either principal or interest was over 90 days past due were as follows:-

	31.12.05		31.12.04	
	Gross US\$ millions	Net book value US\$ millions	Gross US\$ millions	Net book value US\$ millions
Corporate	40.4	5.5	65.6	22.0
Financial institutions	12.6	-	17.0	3.8
Sovereign	0.7	0.5	450.1	0.8
	<u>53.7</u>	<u>6.0</u>	<u>532.7</u>	<u>26.6</u>

The overdue status of past due loans based on original contractual maturities was as follows:-

	31.12.05 US\$ millions	31.12.04 US\$ millions
Within 6 months	-	-
7 months to 1 year	2.8	-
2 to 5 years	43.3	67.8
Over 5 years	7.6	464.9
	<u>53.7</u>	<u>532.7</u>

At 31st December 2005 uncollected interest-in-suspense on past due loans amounted to US\$3.3 million (2004: US\$680.4 million).

8. OTHER ASSETS

	31.12.05 US\$ millions	31.12.04 US\$ millions
Accrued interest, fees and commissions	272.0	184.8
Derivative financial instruments	36.4	26.3
Fixed assets	17.1	17.8
Deferred items	10.0	10.2
Outstanding security settlements	7.9	20.0
Prepayments	7.6	3.0
Prepaid pension cost	-	2.1
Other, including accounts receivable	17.5	23.7
	<u>368.5</u>	<u>287.9</u>

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 24(d).

An analysis of the prepaid pension cost is set out in note 9.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

9. POST RETIREMENT BENEFITS

The Group contributes to defined benefit and defined contribution pension plans which cover substantially all its employees.

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31st December 2005 amounted to US\$4.6 million (2004: US\$3.5 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit pension plan for substantially all its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The pension costs are charged to income so as to spread the regular cost of the pensions over the service lives of the employees, in accordance with the advice of an independent qualified actuary who conducts a full valuation of the plan every three years using the projected unit credit method. In the intervening years the calculation is updated based on information received from the actuary. The latest full actuarial valuation was carried out at 1st January 2004.

The amount recognised in the consolidated balance sheet is analysed as follows:-

	31.12.05 US\$ millions	31.12.04 US\$ millions
Fair value of plan assets	105.9	100.0
Present value of fund obligations	138.1	134.4
	(32.2)	(34.4)
Unrecognised actuarial loss	30.7	36.5
Net (liability) / asset in the consolidated balance sheet	(1.5)	2.1

The movements in the net (liability) / asset recognised in the consolidated balance sheet were as follows:-

	2005 US\$ millions	2004 US\$ millions
At 1 st January	2.1	5.6
Net expense included in staff expenses	(6.2)	(6.6)
Contributions paid	2.3	3.1
Exchange differences	0.3	-
At 31 st December	(1.5)	2.1

The amounts recognised in the consolidated statement of income were as follows:-

	2005 US\$ millions	2004 US\$ millions
Current service cost	4.0	5.9
Interest cost	6.7	6.0
Expected return on plan assets	(6.4)	(6.0)
Losses on curtailments and settlements	0.2	-
Amortisation of actuarial loss	1.7	0.7
Total included in staff expenses	6.2	6.6

9. POST RETIREMENT BENEFITS (continued)

The principal actuarial assumptions used for accounting purposes were as follows:-

	2005	2004
Discount rate	4.9%	5.3%
Expected return on plan assets	6.2%	6.8%
Future salary increases	4.4%	4.3%
Future increases to pensions in payment	2.9%	2.8%

10. DEPOSITS

Deposits from customers include deposits from central banks.

The geographical composition of total deposits was as follows:-

	31.12.05 US\$ millions	31.12.04 US\$ millions
GCC countries	9,884.9	7,070.5
Other countries	3,577.6	3,844.3
	<u>13,462.5</u>	<u>10,914.8</u>

GCC deposits comprise deposits from GCC country governments and central banks and other institutions headquartered in the GCC states.

11. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the available-for-sale and trading security portfolios. At 31st December 2005, the fair value of available-for-sale and trading securities that had been pledged as collateral under repurchase agreements was US\$3,395.1 million and US\$359.6 million respectively (2004: US\$3,730.2 million and US\$74.0 million respectively).

12. OTHER LIABILITIES

	31.12.05 US\$ millions	31.12.04 US\$ millions
Accrued interest	209.3	143.8
Derivative financial instruments	123.8	200.5
Minority interests	84.4	40.5
Deferred items	70.9	66.0
Outstanding security settlements	28.3	20.1
Pension plan liability	1.5	-
Other, including accounts payable and accrued expenses	78.1	54.7
	<u>596.3</u>	<u>525.6</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

12. OTHER LIABILITIES (continued)

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 24(d).

Minority interests represent minority interests in fund products managed by the Bank and its subsidiaries. Fund products in which the Bank holds, directly or indirectly, more than half of the net asset value are accounted for on a consolidated basis.

An analysis of the pension plan liability is set out in note 9.

13. TERM FINANCING

	Maturity	31.12.05 US\$ millions	31.12.04 US\$ millions
Floating rate loan	2006	55.0	55.0
Islamic murabaha term facilities	2006	82.4	82.4
Floating rate note	2007	350.0	325.0
Islamic murabaha term facilities	2007	57.4	57.4
Floating rate loan	2008	6.1	6.1
Floating rate repo	2007-2009	500.0	500.0
Floating rate loan	2009	50.0	50.0
Islamic murabaha term facilities	2009	29.0	29.0
Floating rate loan	2010	800.0	-
Islamic murabaha term facilities	2010	14.6	-
Floating rate loans	2005	-	503.1
Islamic murabaha term facilities	2005	-	70.3
		<u>1,944.5</u>	<u>1,678.3</u>

14. SUBORDINATED TERM FINANCING

	31.12.05 US\$ millions	31.12.04 US\$ millions
Floating rate loan due in 2011	100.0	100.0
Floating rate loan due in 2011	50.0	50.0
Floating rate note due in 2015	400.0	-
	<u>550.0</u>	<u>150.0</u>

The subordinated term financing facilities represent unsecured obligations of the Group and are subordinated in right of payment to the claims of depositors and other creditors of the Group that are not also subordinated. The subordinated financing facilities have been approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency.

15. SHARE CAPITAL

The authorised share capital at 31st December 2005 comprised 3.0 billion shares of US\$1 each (2004: 3.0 billion shares of US\$1 each). The issued share capital at 31st December 2005 comprised 1.0 billion shares of US\$1 each (2004: 1.0 billion shares of US\$1 each). All issued shares are fully paid.

16. RESERVES

	Compulsory reserve US\$ million	Voluntary reserve US\$ million	Cash flow hedge reserve US\$ million	Available- for-sale securities revaluation reserve US\$ million	Total US\$ million
At 31 st December 2003 as previously reported	110.2	47.7	8.4	60.5	226.8
Effect of adopting IAS 39 (revised):-					
- Transfer of net fair value loss on available-for-sale securities from retained earnings	-	-	-	(15.8)	(15.8)
Opening balances restated	110.2	47.7	8.4	44.7	211.0
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	-	56.9	56.9
- Cash flow hedges: net fair value losses	-	-	(0.1)	-	(0.1)
Transfers in the year:-					
- Transfers to net income	-	-	(3.9)	(4.1)	(8.0)
Net (losses)/gains recognised directly in equity	-	-	(4.0)	52.8	48.8
Transfers from retained earnings	15.0	15.0	-	-	30.0
At 31 st December 2004	125.2	62.7	4.4	97.5	289.8
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	-	15.0	15.0
- Cash flow hedges: net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(3.2)	(5.0)	(8.2)
Net (losses)/gains recognised directly in equity	-	-	(6.2)	10.0	3.8
Transfers from retained earnings	20.5	20.5	-	-	41.0
At 31 st December 2005	145.7	83.2	(1.8)	107.5	334.6

In accordance with the Bank's articles of association, 10 per cent of the Bank's net profit for the year is required to be transferred to each of the compulsory and voluntary reserves. Transfers to the non-distributable compulsory reserve are required until such time as this reserve represents 50 per cent of the issued share capital of the Bank. The voluntary reserve may be utilised at the discretion of the Board of Directors.

17. DIVIDENDS

Dividends are not accounted for until they have been ratified at the general assembly meeting. The dividend ratified in respect of 2005 will be accounted for in equity as an appropriation of retained earnings in the year ending 31st December 2006.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

18. OTHER INCOME

	2005	2004
	US\$ millions	US\$ millions
Dividend income	46.0	32.8
Profit on available-for-sale securities	45.6	23.2
Investment banking and management fees	29.8	23.6
Profit on trading securities	21.4	23.9
Commissions on letters of credit and guarantee	12.0	10.1
Profit on foreign exchange	10.7	6.5
Other fee and sundry income	3.6	3.4
	<u>169.1</u>	<u>123.5</u>

Dividend income comprised dividends received of US\$8.0 million and US\$38.0 million from equities and equity funds in the trading and available-for-sale security portfolios respectively (2004: US\$7.6 million and US\$25.2 million respectively). The funding cost in respect of the equities and equity funds is included in interest expense in the consolidated statement of income.

Investment banking and management fees comprise fees relating to the provision of investment management and financial services, including asset and fund management, underwriting activities, and services relating to structured financing, privatisations, IPO's, and mergers and acquisitions.

19. SEGMENTAL INFORMATION

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format, business segments, is based on the products and services provided or the type of customer serviced and reflects the manner in which financial information is evaluated by management and the Board of Directors.

a) Business segments

For financial reporting purposes, the Group is organised into three main business segments:-

- Merchant Banking: the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers, and the provision of financial advisory services relating to structured financing, privatisations, IPOs and mergers and acquisitions.
- Treasury: the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary investment activities and the management of the Group's balance sheet, including Funding.
- Financial Markets: the provision of asset and fund management services, and proprietary trading activities.

The results reported for the business segments are based on the Group's internal financial reporting systems. The accounting policies of the segments are the same as those applied in the preparation of the Group's consolidated financial statements as set out in note 2. Transactions between business segments are conducted on normal commercial terms and conditions. Transfer pricing between the business units is based on the market cost of funds.

Segment results, assets and liabilities comprise items directly attributable to the business segments. The 'corporate and other' category comprises items which are not directly attributable to specific business segments, including investments of a strategic nature, and income arising on the recharge of the Group's net free capital to business units. Unallocated overheads and exceptional charges are reported separately.

19. SEGMENTAL INFORMATION (continued)

The business segment analysis is as follows:-

	Merchant Banking US\$ millions	Treasury US\$ millions	Financial Markets US\$ millions	Corporate and other US\$ millions	Total US\$ millions
2005					
Net interest and other income	124.7	138.5	36.1	46.7	346.0
Segment result	109.5	127.8	21.0	45.6	303.9
Unallocated overhead					(96.6)
Taxation charge on overseas activities					(4.3)
Net income after tax					203.0
Segment assets	6,428.5	13,590.5	2,782.4	55.2	22,856.6
Segment liabilities	6.6	18,907.7	143.6	2,080.4	21,138.3
Total equity					1,718.3
Total liabilities and equity					22,856.6
2004					
Net interest and other income	52.6	121.9	54.4	43.9	272.8
Segment result	39.7	111.7	39.4	42.8	233.6
Unallocated overhead					(85.2)
Taxation credit on overseas activities					1.8
Net income after tax					150.2
Segment assets	4,843.7	12,320.6	2,008.1	66.6	19,239.0
Segment liabilities	4.1	16,171.9	88.5	1,387.9	17,652.4
Total equity					1,586.6
Total liabilities and equity					19,239.0

b) Geographical segments

Although the Group's three main business segments are managed on a worldwide basis, they are considered to operate in two geographical markets: the GCC and the rest of the world.

The geographical composition of net interest and other income based on the location in which transactions are booked and income is recorded was as follows:-

	2005 US\$ millions	2004 US\$ millions
GCC countries	255.5	182.2
Other countries	90.5	90.6
	346.0	272.8

The geographical analyses of deposits and risk assets are set out in notes 10 and 21 respectively.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

20. RISK MANAGEMENT

The principal risks associated with the Group's businesses are credit risk, market risk, liquidity risk and operational risk. The Group has a comprehensive risk management framework in place for managing these risks which is constantly evolving as the business activities change in response to credit, market, product and other developments. The risk management framework is guided by a number of overriding principles including the formal definition of risk management governance, an evaluation of risk appetite expressed in terms of formal risk limits, risk oversight independent of business units, disciplined risk assessment and measurement including Value-at-Risk (VaR) methodologies and portfolio stress testing, and risk diversification. The Board of Directors set the Group's overall risk parameters and risk tolerances, and the significant risk management policies. A Board Risk Policy Committee reviews and reports to the Board of Directors on the Group's risk profile and risk taking activities. A Management Committee, chaired by the Group Chief Executive Officer, has the primary responsibility for sanctioning risk taking activities and risk management policies within the overall risk parameters and tolerances defined by the Board of Directors. A Group Risk Committee, under the chairmanship of the Chief Operating Officer and comprising the Group's most senior risk professionals, provides a forum for the review and approval of risk measurement methodologies, risk control processes and the approval of new products. The Group Risk Committee also reviews all risk policies and limits that require the formal approval of the Management Committee. The risk management control process is based on a detailed structure of policies, procedures and limits, and comprehensive risk measurement and management information systems for the control, monitoring and reporting of risks. Periodic reviews by internal and external auditors and regulatory authorities subject the risk management processes to additional scrutiny which help to further strengthen the risk management environment.

The principal risks associated with the Group's businesses and the related risk management processes are commented on as follows:-

Credit risk

Credit risk is the risk that counterparties will be unable to meet their obligations to the Group. Credit risk arises principally from the Group's lending and investment activities in addition to other transactions involving both on and off balance sheet financial instruments. Disciplined processes are in place at both the business unit and corporate level that are intended to ensure that risks are accurately assessed and properly approved and monitored. Formal credit limits are applied at the individual transaction, counterparty, country and portfolio levels. Overall exposures are also evaluated to ensure a broad diversification of credit risk. The credit management process involves the monitoring of concentrations by product, industry, single obligor, risk grade and geography, and the regular appraisal of counterparty credit quality through the analysis of qualitative and quantitative information. The Group also mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

The geographical distribution of risk assets is set out in note 21. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 24 while the notional and risk-weighted exposures for credit-related financial instruments are detailed in note 25.

Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk, foreign exchange risk and equity price risk associated with its trading, investment and asset and liability management activities. The portfolio effects of holding a diversified range of instruments across a variety of businesses and geographic areas contribute to a reduction in the potential negative impact on earnings from market risk factors.

20. RISK MANAGEMENT (continued)

- Trading market risk: The Group's trading activities principally comprise trading in debt and equity securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and commodity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. The Group supplements daily VaR calculations with portfolio stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. It is recognised that VaR is not a measure of the absolute limit of market risk and that losses in excess of the VaR amounts will, on occasion, arise. The composition of the debt and equity trading securities is set out in note 5. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 24.

The VaR by risk class for the Group's trading positions, as calculated in accordance with the basis set out in note 27, was as follows:-

	31.12.05 US\$ millions	2005 average US\$ millions	31.12.04 US\$ millions	2004 average US\$ millions
Interest rate risk	4.6	4.5	5.5	4.8
Foreign exchange risk	1.3	1.2	1.1	1.3
Equity risk	2.8	2.9	3.1	2.4
Total diversified risk	6.4	6.3	7.1	6.4

- Non-trading market risk: Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities is set out in note 23. The Group does not maintain material non-trading foreign currency open positions. In general, the Group's policy is to match assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in note 24(e).

The more significant market risk-related activities of a non-trading nature undertaken by the Group, the related risks associated with those activities and the types of derivative financial instruments used to manage and mitigate such risks are summarised as follows:-

Activity	Risk	Risk mitigant
Management of the return on variable rate assets funded by shareholders' funds	Reduced profitability due to a fall in short term interest rates	Receive fixed interest rate swaps
Fixed rate assets funded by floating rate liabilities	Sensitivity to increases in short term interest rates	Pay fixed interest rate swaps
Investment in foreign currency assets	Sensitivity to strengthening of US\$ against other currencies	Currency swaps
Profits generated in foreign currencies	Sensitivity to strengthening of US\$ against other currencies	Forward foreign exchange contracts and purchased currency options

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

20. RISK MANAGEMENT (continued)

Liquidity risk

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Group, even in adverse conditions. In normal conditions the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide security of access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The Group's liquidity controls ensure that, over the short term, the future profile of cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity controls also provide for the maintenance of a stock of liquid and readily realisable assets and a diversified deposit base in terms of both maturities and range of depositors.

An analysis of available-for-sale securities by rating classification is set out in note 6(a). The maturity profile of assets and liabilities is set out in note 22.

Operational risk

Operational risk is the risk of unexpected losses resulting from inadequate or failed internal controls or procedures, systems failures, fraud, business interruption, compliance breaches, human error, management failure or inadequate staffing.

A framework and methodology has been developed to identify and control the various operational risks. While operational risk cannot be entirely eliminated, it is managed and mitigated by ensuring that the appropriate infrastructure, controls, systems, procedures, and trained and competent people are in place throughout the Group. A strong internal audit function makes regular, independent appraisals of the control environment in all identified risk areas. Adequately tested contingency arrangements are also in place to support operations in the event of a range of possible disaster scenarios.

21. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.05				31.12.04	
	Placements & other liquid assets	Securities	Loans and advances	Credit-related contingent items	Total	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	961.5	1,090.9	5,525.1	2,344.2	9,921.7	8,273.5
Other Middle East & North Africa	103.7	79.8	299.9	70.8	554.2	597.2
Europe	3,696.3	3,000.7	837.6	268.9	7,803.5	6,076.5
North America	367.7	5,211.3	371.1	255.6	6,205.7	5,405.9
Asia	295.9	266.6	182.2	0.1	744.8	876.2
Latin America	-	197.8	-	10.0	207.8	151.0
	5,425.1	9,847.1	7,215.9	2,949.6	25,437.7	21,380.3

An analysis of derivative and foreign exchange instruments is set out in note 24.

22. MATURITIES OF ASSETS AND LIABILITIES

The maturity profile of assets and liabilities based on the remaining periods to contractual maturity dates was as follows:-

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions	Total US\$ millions
At 31 st December 2005						
Cash and other liquid assets	344.4	1.0	-	-	-	345.4
Placements	4,975.6	104.1	-	-	-	5,079.7
Trading securities	2,007.5	-	-	-	-	2,007.5
Available-for-sale securities	252.6	262.2	737.3	1,729.4	4,858.1	7,839.6
Loans and advances	2,472.5	1,193.4	1,796.7	751.4	1,001.9	7,215.9
Other assets	266.2	63.6	-	-	38.7	368.5
Total assets	10,318.8	1,624.3	2,534.0	2,480.8	5,898.7	22,856.6
Deposits	12,683.9	724.0	54.6	-	-	13,462.5
Securities sold under agreements to repurchase	2,856.4	855.1	-	-	-	3,711.5
Securities sold but not yet purchased	873.5	-	-	-	-	873.5
Other liabilities	377.5	18.3	8.6	20.2	171.7	596.3
Term financing	21.0	116.4	813.5	993.6	550.0	2,494.5
Equity	-	-	-	-	1,718.3	1,718.3
Total liabilities & equity	16,812.3	1,713.8	876.7	1,013.8	2,440.0	22,856.6
At 31 st December 2004						
Total assets	6,703.9	2,005.3	2,528.6	1,855.3	6,145.9	19,239.0
Total liabilities & equity	13,199.6	2,880.9	832.6	408.8	1,917.1	19,239.0

The asset and liability maturities are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Counterparties each with deposits over US\$10.0 million at 31st December 2005 had average deposits throughout 2005 amounting to US\$10,740.9 million (2004: US\$9,508.3 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

23. INTEREST RATE RISK

The repricing profile and effective interest rates of the various asset and liability categories were as follows:-

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions	Effective Interest Rates %
At 31 st December 2005							
Cash and other liquid assets	344.4	1.0	-	-	-	345.4	3.25
Placements	4,318.8	291.7	169.2	300.0	-	5,079.7	4.28
Trading securities	1,687.1	-	-	-	320.4	2,007.5	5.53
Available-for-sale securities:-							
- Fixed rate	175.4	-	40.0	159.2	-	374.6	3.73
- Floating rate	5,890.7	814.5	22.3	-	-	6,727.5	4.80
- Equities & equity funds	-	-	-	-	737.5	737.5	-
Loans and advances	5,246.4	1,789.5	215.3	-	(35.3)	7,215.9	5.16
Other assets	-	-	-	-	368.5	368.5	-
Total assets	17,662.8	2,896.7	446.8	459.2	1,391.1	22,856.6	
Deposits	12,954.4	413.8	94.3	-	-	13,462.5	4.15
Securities sold under agreements to repurchase	3,493.5	159.0	59.0	-	-	3,711.5	3.48
Securities sold but not yet purchased	873.5	-	-	-	-	873.5	5.58
Other liabilities	-	-	-	-	596.3	596.3	-
Term financing	2,494.5	-	-	-	-	2,494.5	4.50
Equity	-	-	-	-	1,718.3	1,718.3	-
Total liabilities & equity	19,815.9	572.8	153.3	-	2,314.6	22,856.6	
Interest rate sensitivity gap	(2,153.1)	2,323.9	293.5	459.2	(923.5)	-	
Cumulative interest rate sensitivity gap	(2,153.1)	170.8	464.3	923.5	-	-	
At 31 st December 2004							
Cumulative interest rate sensitivity gap	(678.8)	595.1	507.7	1,053.1	-	-	

The repricing profile is based on the remaining period to the next interest repricing date. The repricing profile of placements incorporates the effect of interest rate swaps used to lock-in a return on the Group's net free capital funds. Derivative financial instruments that have been used for asset and liability management purposes to hedge exposure to interest rate risk are incorporated in the repricing profiles of the related hedged assets and liabilities. The non-specific loan provision is deducted from non-interest bearing assets.

The substantial majority of assets and liabilities reprice within one year. Accordingly there is limited exposure to interest rate risk. The principal interest rate risk beyond one year as set out in the asset and liability repricing profile, represents the investment of the Group's net free capital in fixed rate government securities and fixed receive interest rate swaps. At 31st December 2005 the modified duration of these fixed rate securities and interest rate swaps was 3.8. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate securities and interest rate swaps was US\$174,000.

23. INTEREST RATE RISK (continued)

Based on the repricing profile at 31st December 2005, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent increase in interest rates across all maturities would result in a reduction in net income before tax for the following year and in the Group's equity by approximately US\$6.6 million and US\$8.3 million respectively (2004: US\$6.1 million and US\$7.6 million respectively). The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

The Value-at-Risk by risk class for the Group's trading positions is set out in note 20. The market risk relating to foreign exchange and derivative trading instruments is set out in note 24.

24. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management (ALM) activity to hedge its own exposure to market risk. Derivative instruments are contracts whose value is derived from one or more financial instruments or indices. They include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and commodity markets. Derivatives and foreign exchange are subject to the same types of credit and market risk as other financial instruments. The Group has appropriate and comprehensive Board-approved policies and procedures for the control of exposure to both market and credit risk from its derivative and foreign exchange activities.

In the case of derivative transactions, the notional principal typically does not change hands. It is simply a quantity which is used to calculate payments. While notional principal is a volume measure used in the derivative and foreign exchange markets, it is neither a measure of market nor credit risk. The Group's measure of credit exposure is the cost of replacing contracts at current market rates should the counterparty default prior to the settlement date. Credit risk amounts represent the gross unrealised gains on non-margined transactions before taking account of any collateral held or any master netting agreements in place.

The Group participates in both exchange traded and over-the-counter (OTC) derivative markets. Exchange traded instruments are executed through a recognised exchange as standardised contracts and primarily comprise futures and options. OTC contracts are executed between two counterparties who negotiate specific agreement terms, including the underlying instrument, notional amount, maturity and, where appropriate, exercise price. In general, the terms and conditions of these transactions are tailored to the requirements of the Group's customers although conform to normal market practice. Industry standard documentation is used, most commonly in the form of a master agreement. The existence of a master netting agreement is intended to provide protection to the Group in the event of a counterparty default.

The Group's principal foreign exchange transactions are forward foreign exchange contracts, currency swaps and currency options. Forward foreign exchange contracts are agreements to buy or sell a specified quantity of foreign exchange on a specific future date at an agreed rate. A currency swap involves the exchange, or notional exchange, of equivalent amounts of two currencies and a commitment to exchange interest periodically until the principal amounts are re-exchanged on a specified future date. Currency options provide the buyer with the right, but not the obligation, either to purchase or sell a fixed amount of a currency at a specified exchange rate on or before a specified future date. As compensation for assuming the option risk, the option seller (or writer) receives a premium at the start of the option period.

The Group's principal interest rate-related derivative transactions are interest rate swaps, forward rate agreements, futures and options. An interest rate swap is an agreement between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract. Certain agreements combine interest rate and foreign currency swap transactions, which may or may not include the exchange of principal amounts. In a forward rate agreement, two parties agree a future settlement of the difference between an agreed rate and a future interest rate, applied to a notional principal amount for an agreed period. The settlement, which generally occurs at the start of the contract period, is the discounted present value of the payment that would otherwise be made at the end of that period. An interest rate future is an exchange traded contract for the delivery of a standardised amount of a fixed income security or time deposit at a future specified date. Interest rate options, including caps, floors and collars, provide the buyer with the right, but not the obligation, either to purchase or sell an interest rate financial instrument at a specified price or rate on or before a specified future date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

24. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

The Group's principal equity-related derivative transactions are equity and stock index options. An equity option provides the buyer with the right, but not the obligation, either to purchase or sell a specified stock or index at a specified price or level on or before a specified future date.

The Group buys and sells credit protection through credit default swaps. Credit default swaps provide protection against the decline in value of a referenced asset as a result of credit events such as default or bankruptcy. It is similar in structure to an option whereby the purchaser pays a premium to the seller of the credit default swap in return for payment related to the deterioration in value of the referenced asset. Credit default swaps purchased by the Group, which are principally entered into to hedge credit risk exposures within the trading securities portfolio, are classified as derivative financial instruments. Credit default swaps sold by the Group are classified as direct credit substitutes within credit-related financial instruments.

The Group also transacts in other derivative products including exchange traded commodity options.

a) Product analysis

The table below summarises the aggregate notional and credit risk amounts of foreign exchange and interest rate-related derivative contracts.

	Notional amounts			Credit risk
	Trading US\$ millions	Hedging US\$ millions	Total US\$ millions	amounts US\$ millions
At 31 st December 2005				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	1,412.0	2,350.8	3,762.8	12.2
Options purchased	124.5	28.7	153.2	3.5
Options written	124.5	-	124.5	-
	<u>1,661.0</u>	<u>2,379.5</u>	<u>4,040.5</u>	<u>15.7</u>
Interest rate contracts:-				
Futures	2,007.2	-	2,007.2	-
Forward rate agreements	-	95.7	95.7	-
Interest rate swaps and swaptions	1,604.4	6,614.0	8,218.4	31.6
Options, caps and floors purchased	2,849.1	11.8	2,860.9	-
Options, caps and floors written	4,374.8	11.8	4,386.6	-
	<u>10,835.5</u>	<u>6,733.3</u>	<u>17,568.8</u>	<u>31.6</u>
Equity contracts:-				
Contracts for differences	36.9	-	36.9	2.1
Credit contracts:-				
Protection bought	229.7	-	229.7	0.4
Commodity contracts:-				
Options purchased	3.1	-	3.1	-
Total	<u>12,766.2</u>	<u>9,112.8</u>	<u>21,879.0</u>	<u>49.8</u>
At 31 st December 2004				
Total	<u>5,183.2</u>	<u>8,335.9</u>	<u>13,519.1</u>	<u>62.6</u>

Financial futures are exchange traded and therefore not subject to credit risk. There is no credit risk in respect of options, caps and floors written as they represent obligations of the Group.

24. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

At 31st December 2005 the Value-at-Risk of the foreign exchange, interest rate, equity, credit and commodity derivative trading contracts analysed in the table on the previous page, as calculated in accordance with the basis set out in note 27, was nil, US\$0.7 million, nil, US\$1.2 million and US\$0.4 million respectively (2004: US\$1.4 million, US\$0.2 million, nil, nil and nil respectively). Value-at-Risk is a measure of market risk exposure and is accordingly separate and in addition to the credit risk exposure represented by the credit risk amounts in the table on the previous page.

b) Counterparty analysis

Credit risk amounts	31.12.05		Total US\$ millions	31.12.04
	Banks US\$ millions	Other US\$ millions		Total US\$ millions
OECD countries	39.6	0.3	39.9	47.1
GCC countries	2.6	7.2	9.8	14.8
Other countries	0.1	-	0.1	0.7
	<u>42.3</u>	<u>7.5</u>	<u>49.8</u>	<u>62.6</u>

Credit risk is concentrated on major OECD-based banks.

c) Maturity analysis

	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
At 31 st December 2005					
Foreign exchange contracts	4,036.9	3.6	-	-	4,040.5
Interest rate contracts	13,336.3	1,412.0	1,307.8	1,512.7	17,568.8
Equity contracts	-	-	-	36.9	36.9
Credit contracts	28.1	15.0	43.4	143.2	229.7
Commodity contracts	3.1	-	-	-	3.1
Total	<u>17,404.4</u>	<u>1,430.6</u>	<u>1,351.2</u>	<u>1,692.8</u>	<u>21,879.0</u>
At 31 st December 2004					
Total	<u>8,576.2</u>	<u>1,825.3</u>	<u>1,327.5</u>	<u>1,790.1</u>	<u>13,519.1</u>

The Group's derivative and foreign exchange activities are predominantly short-term in nature. Transactions with maturities over one year principally represent either fully offset trading transactions or transactions that are designated, and qualify, as fair value and cash flow hedges.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

24. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

d) Fair value analysis

	31.12.05		31.12.04	
	Positive fair value US\$ millions	Negative fair value US\$ millions	Positive fair value US\$ millions	Negative fair value US\$ millions
Derivatives held for trading:-				
Forward foreign exchange contracts	5.1	(2.7)	8.1	(14.1)
Foreign exchange options	5.8	(5.8)	0.4	(0.4)
Interest rate futures	0.7	-	0.1	-
Interest rate swaps and swaptions	13.7	(12.6)	13.2	(12.5)
Interest rate options, caps and floors	0.4	(0.5)	-	-
Equities - contracts for differences	2.1	(4.2)	0.8	-
Credit default swaps	0.4	(1.2)	-	-
	<u>28.2</u>	<u>(27.0)</u>	<u>22.6</u>	<u>(27.0)</u>
Derivatives held as fair value hedges:-				
Interest rate swaps	8.2	(93.0)	3.7	(172.6)
Derivatives held as cash flow hedges:-				
Interest rate swaps	-	(3.8)	-	(0.9)
Gross positive/(negative) fair value	36.4	(123.8)	26.3	(200.5)
Effect of master netting agreements	-	-	-	-
Net amount included in other assets/(other liabilities)	<u>36.4</u>	<u>(123.8)</u>	<u>26.3</u>	<u>(200.5)</u>

e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2005 or at 31st December 2004.

f) Hedge effectiveness

There were no ineffective portions of fair value or cash flow derivative hedging transactions recognised in the consolidated statement of income in either the year ended 31st December 2005 or the year ended 31st December 2004.

25. CREDIT-RELATED FINANCIAL INSTRUMENTS

Credit-related financial instruments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The table below sets out the notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated in accordance with the capital adequacy guidelines of the Basel Committee on Banking Supervision.

	31.12.05		31.12.04	
	Notional principal amount US\$ millions	Risk- weighted exposure US\$ millions	Notional principal amount US\$ millions	Risk- weighted exposure US\$ millions
Direct credit substitutes	335.7	271.7	141.7	113.2
Transaction-related contingent items	838.2	388.2	645.7	317.3
Short-term self-liquidating trade-related contingent items	234.3	40.0	175.4	23.5
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	1,541.4	681.2	1,466.4	623.8
	<u>2,949.6</u>	<u>1,381.1</u>	<u>2,429.2</u>	<u>1,077.8</u>

26. CONTINGENT LIABILITIES

Litigation

The Bank and its subsidiaries are engaged in litigation in various jurisdictions. The litigation involves claims by and against Group companies which have arisen in the ordinary course of business. The directors of the Bank, after reviewing the claims pending against Group companies and based on the advice of relevant professional legal advisors, are satisfied that the outcome of these claims will not have a material adverse effect on the financial position of the Group.

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27. CAPITAL ADEQUACY

The risk asset ratio calculated in accordance with the capital adequacy guidelines of the Basel Committee on Banking Supervision was as follows:-

	31.12.05		31.12.04
	US\$ millions		US\$ millions
Regulatory capital base			
Tier I capital:			
Total equity	1,718.3		1,586.6
Adjustment to exclude net fair value gains	(105.7)		(101.9)
Adjusted Tier I capital	1,612.6		1,484.7
Tier II capital:			
Subordinated term financing	550.0		150.0
Non-specific loan provision	50.0		50.0
Total Tier II capital	600.0		200.0
Total regulatory capital base	(a) 2,212.6		1,684.7
Risk-weighted exposure			
	Notional	Risk-	Notional
	principal	weighted	principal
	amount	exposure	amount
	US\$ millions	US\$ millions	US\$ millions
Credit risk			
Balance sheet items:			
Cash and other liquid assets	345.4	68.2	144.6
Placements	5,079.7	1,152.5	3,286.5
Securities	9,847.1	7,003.2	10,081.5
Loans and advances	7,215.9	5,907.5	5,438.5
Other assets	368.5	229.7	287.9
	22,856.6	14,361.1	19,239.0
Off-balance sheet items:			
Credit-related contingent items	2,949.6	1,381.1	2,429.2
Forward asset purchases	120.2	24.0	-
Foreign exchange-related items	4,040.5	13.3	4,758.0
Derivative-related items	17,838.5	11.5	8,761.1
	24,948.8	1,429.9	15,948.3
Credit risk-weighted exposure		15,791.0	13,860.1
Market risk			
General market risk		353.3	362.6
Specific market risk		1,332.4	1,083.0
Market risk-weighted exposure		1,685.7	1,445.6
Total risk-weighted exposure	(b)	17,476.7	15,305.7
Risk asset ratio [(a)/(b) x 100]		12.7%	11.0%

27. CAPITAL ADEQUACY (continued)

In accordance with the capital adequacy guidelines of the Bank's regulator, the Bahrain Monetary Agency (BMA), revaluation gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions are excluded from Tier I capital with the exception of losses arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale. In accordance with the BMA's guidelines, gains arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale are included in Tier II capital. There were no fair value gains or losses in relation to marketable equity securities classified as available-for-sale at either 31st December 2005 or at 31st December 2004.

The Group calculates the capital requirement for general market risk using a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risks issued by the Basle Committee in January 1996. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the BMA. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at the regulatory minimum of 3.0 (2004: 3.0) by the BMA.

Value-at-Risk is calculated based on a 99 per cent confidence level, a ten-day holding period and a twelve-month historical observation period of unweighted data from the DataMetrics regulatory data set. Correlations across broad risk categories are excluded. Prescribed additions in respect of specific risk are made to the general market risk. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the 8 per cent minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

28. FIDUCIARY ACTIVITIES

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31st December 2005 was US\$17,918.7 million (2004: US\$13,583.7 million).

29. RELATED PARTY TRANSACTIONS

The Group's related party transactions are limited to the compensation of its directors and executive officers.

The compensation of key management personnel was as follows:-

	2005	2004
	US\$ millions	US\$ millions
Short term employee benefits	9.0	7.2
Post-employment benefits	0.6	0.6
	<u>9.6</u>	<u>7.8</u>

Key management personnel comprise members of the Board of Directors, the Group Chief Executive Officer, the Chief Operating Officer and the Managing Directors of the Group.

There were no other related party transactions.

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For the year ended 31st December 2005

30. FAIR VALUE OF FINANCIAL INSTRUMENTS

The table set out below compares the estimated fair values of all on- and off-balance sheet financial instruments with their respective book values. With the exception of trading securities, available-for-sale securities and derivative financial instruments, the Group's financial instruments are accounted for under the historical cost method. By contrast the fair value represents the amount at which an asset could be exchanged, or a liability settled, in a transaction between knowledgeable, willing parties in an arm's length transaction. Differences therefore can arise between book values under the historical cost method and fair value estimates. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation or to undertake a transaction on adverse terms. Generally accepted methods of determining fair value include reference to quoted market prices or to the pricing prevailing for similar financial instruments and the use of estimation techniques such as discounted cash flow analysis.

	Book value US\$ millions	Fair value US\$ millions	Excess US\$ millions
At 31 st December 2005			
Assets			
Cash and other liquid assets	345.4	345.4	-
Placements with banks	5,079.7	5,079.7	-
Trading securities	2,007.5	2,007.5	-
Available-for-sale securities	7,839.6	7,839.6	-
Loans and advances	7,215.9	7,217.5	1.6
Other assets	368.5	368.5	-
Liabilities			
Deposits	13,462.6	13,462.6	-
Securities sold under agreements to repurchase	3,711.5	3,711.5	-
Securities sold but not yet purchased	873.5	873.5	-
Other liabilities	596.3	596.3	-
Term financing	2,494.5	2,494.5	-
Credit-related contingent items			-
Excess of net fair values over net book values			<u>1.6</u>
At 31 st December 2004			
Excess of net fair values over net book values			<u>4.1</u>

Based on the valuation methodologies outlined below, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values as at 31st December 2005 by US\$1.6 million (2004: US\$4.1 million).

a) Securities

The fair value of securities was based on quoted market prices with the exception of investments in unquoted equity investments, the fair values of which were based on their carrying amounts.

b) Loans and advances

The fair value of floating rate loans was principally estimated at book value less provisions for impairment. The fair value of troubled sovereign debt was based on market bid prices. The fair value of impaired loans was estimated at the recoverable amount, measured as the present value of expected future cash flows discounted based on the interest rate at the inception of the loan. The fair value of fixed rate loans was estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality.

30. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

c) Term financing

The fair value of term financing was based on book value as the financing is on a floating rate basis and as the applicable margins approximate the current spreads that would apply for borrowings with similar maturities. The term financing reprices at least semi-annually.

d) Other on-balance sheet items

The fair values of foreign exchange and derivative financial instruments were based on market prices, discounted cash flow models or option pricing models as appropriate. The fair values of all other on-balance sheet items approximated their respective book values due to their short term nature.

e) Credit-related contingent items

There was no material fair value excess or shortfall in respect of credit-related off-balance sheet financial instruments, which include commitments to extend credit, standby letters of credit and guarantees, as the related future income streams reflected contractual fees and commissions actually charged at the balance sheet date for agreements of similar credit standing and maturity. Specific provisions made in respect of individual transactions where a potential for loss has been identified are included in provisions for the impairment of loans and advances.

31. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the net profit attributable to the shareholders by the weighted average number of shares in issue during the year.

	2005	2004
Net income after tax (US\$ millions)	203.0	150.2
Weighted average number of shares in issue (millions)	1,000.0	1,000.0
Basic earnings per share	<u>US\$0.20</u>	<u>US\$0.15</u>

32. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

	Country of Incorporation	Ownership Interest	
		31.12.05	31.12.04
Gulf International Bank (UK) Limited	United Kingdom	100%	100%
GIB (UK) Capital Investments Limited	United Kingdom	100%	100%
SIB Financial Advisory Services Limited	United Kingdom	100%	100%
GIBINVEST E.C.	Bahrain	100%	100%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS continued

For the year ended 31st December 2005

33. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

	2005 US\$ millions	2004 US\$ millions
Assets		
Cash and other liquid assets	189.1	188.3
Placements with banks	4,588.4	3,656.1
Trading securities	1,751.8	1,480.2
Available-for-sale securities	7,906.0	8,360.9
Loans and advances	6,170.4	4,510.2
Other assets	423.7	337.0
Total assets	21,029.4	18,532.7
Liabilities		
Deposits from banks	4,664.4	4,980.5
Deposits from customers	7,707.9	5,774.9
Securities sold under agreements to repurchase	3,487.8	3,531.1
Securities sold but not yet purchased	691.7	436.9
Other liabilities	678.7	573.0
Term financing	1,918.0	1,635.4
Subordinated term financing	257.8	150.0
Total liabilities	19,406.3	17,081.8
Total equity	1,623.1	1,450.9
Total liabilities & equity	21,029.4	18,532.7

34. PARENT COMPANY

The condensed unconsolidated financial statements of Gulf International Bank B.S.C. were as follows:-

a) Condensed balance sheet

	At 31.12.05 US\$ millions	At 31.12.04 US\$ millions
Assets		
Cash and other liquid assets	286.4	95.9
Placements with banks	3,065.4	2,078.2
Trading securities	256.2	292.8
Available-for-sale securities	7,789.7	8,299.4
Investment in GIB (UK) Limited	330.2	329.5
Loans and advances	6,233.9	4,841.5
Other assets	305.4	220.2
Total assets	18,267.2	16,157.5
Liabilities		
Deposits from banks	3,994.6	4,206.8
Deposits from customers	6,272.6	4,375.2
Securities sold under agreements to repurchase	3,352.5	3,742.9
Other liabilities	434.7	417.7
Term financing	1,944.5	1,678.3
Subordinated term financing	550.0	150.0
Total liabilities	16,548.9	14,570.9
Total equity	1,718.3	1,586.6
Total liabilities & equity	18,267.2	16,157.5

The investment in GIBUK is accounted for at fair value. Gains and losses arising from changes in the fair value of the investment are accounted for in equity. Prior to the adoption of the revised versions of IAS 27 and IAS 39 with effect from 1st January 2005, the investment in GIBUK was accounted for based on the equity method of accounting. The adoption of the revised versions of IAS 27 and IAS 39 resulted in a reduction in the Parent Company's net income after tax for the year ended 31st December 2004 by US\$19.1 million due to the exclusion of GIBUK's net income for the year. There was no impact on the book value of the investment in the Parent Company's balance sheet.

b) Condensed income statement

	Year ended 31.12.05 US\$ millions	Year ended 31.12.04 US\$ millions
Net interest income	148.1	144.8
Provisions for securities	14.3	10.2
Provisions for loans and advances	(9.4)	19.2
Net interest income after provisions	143.2	115.4
Dividend received from GIBUK	13.3	-
Other income	138.9	87.3
Net interest and other income	295.4	202.7
Operating expenses	85.8	71.6
Net income before tax	209.6	131.1
Taxation charge on overseas activities	4.1	-
Net income after tax	205.5	131.1

CORPORATE GOVERNANCE

GOVERNANCE

The Board of Directors and management are committed to complying with established best practice in corporate governance. The following positive steps have been taken to “set the tone at the top” in that regard:

- The Bank (although not a publicly traded company) has progressively adopted international best practices of publicly traded financial institutions, and since 2003 has published a statement on Corporate Governance in its Annual Report.
- The Board has publicised the strategy and objectives it has set for the Bank.
- The Board has approved an organisational structure that reflects best practices in corporate governance.

ORGANISATION

The Bank has an organisational structure in place that segregates functions and responsibilities, reflecting a division of roles and responsibilities between the Board of Directors and management:

- There is an effective and appropriately constituted Board of Directors responsible for the stewardship of the Bank and the supervision of the Bank’s business, that receives from management such information as is required to properly fulfill its duties and the duties of the committees that assist it, and that delegates to management the authority and responsibility for day-to-day business.
- There is an effective and appropriately organised management structure responsible for the day-to-day management of the Bank and the implementation of Board-approved strategy, policies and internal controls.
- There is a division of roles and responsibilities as between the Board of Directors and the Chief Executive Officer, and
- There are defined and documented mandates and

responsibilities (as well as delegated authorities, where applicable) for:

- The Board,
- The Chairman of the Board,
- The Board committees (the Audit Committee, the Risk Policy Committee and the Compensation Committee),
- The Management,
- The Chief Executive Officer, and
- The four management committees (the Management Committee, the Group Risk Committee, the Assets & Liabilities Committee, and the Human Resources Committee).

BOARD OF DIRECTORS

The Board comprises nine non-executive directors, including the Chairman and Vice-Chairman, who together bring a wide range of skills and experience to the Board. Their biographies are set out on page 77.

In accordance with the Bank’s Articles of Association, all directors are appointed every three years by the Bank’s shareholders who consist of the six Gulf Cooperation Council governments, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates, that collectively own 72.5 percent (in equal number of shares) and who each appoint a director, and the Saudi Arabian Monetary Agency (the Central Bank of Saudi Arabia) that owns 27.5 percent and who appoints three directors.

The Bank’s Articles of Association also require that the Bank holds, annually, a properly constituted General Assembly.

The Board is responsible for the strategic direction of the Bank; maintaining an appropriate organisation structure; approving major policies; monitoring business performance, operations and the integrity of internal

controls; nurturing proper and ethical behaviour; providing appropriate oversight and conducting corporate governance in a transparent manner.

The Board performs its responsibilities as a supervisory board while delegating to the Bank's management the responsibility for the management of the Bank within policies, guidelines and parameters set by the Board.

In preparation for Board and Committee meetings, the directors receive in a timely manner regular reports and all other information required for such meetings, supplemented by any additional information specifically requested by the directors from time to time. The directors

also receive monthly financial reports and other regular management reports that enable them to evaluate the Bank's and management's performance against agreed objectives.

As prescribed in the Bank's Articles of Association, the Board plans at least four meetings per year, with further meetings to occur at the discretion of the Board.

In 2005, the Board met six times, the Audit Committee met five times, the Compensation Committee met three times, and the Risk Policy Committee met twice.

The details of committee membership and directors' attendance are set out in the Table below.

THE BOARD OF DIRECTORS & ITS COMMITTEES

Board and committee meetings attendance during 2005

Board Members	Board meetings	Audit Committee meetings	Compensation Committee meetings	Risk Policy Committee meetings
H.E. Sheikh Ebrahim Bin Khalifa Al Khalifa - Chairman (Kingdom of Bahrain)	6 (6)*			
Mr. Abdul Aziz M. Al-Abdulkader - Vice Chairman (Saudi Arabian Monetary Agency)	6 (6)			2 (2)*
Mr. Bader Abdullah Al-Rushaid Al-Bader (State of Kuwait)	6 (6)			2 (2)
Dr. Hamad Bin Sulaiman Al-Bazai (Kingdom of Saudi Arabia)	6 (6)	5 (5)*	3 (3)*	
Mr. Saud Bin Nassir Al-Shukaily (Sultanate of Oman)	5 (6)	5 (5)		
Mr. Khalid Bin Abdulla Al-Suwaidi (State of Qatar)	6 (6)		3 (3)	
Mr. Nasser Khamis Al-Suwaidi (The United Arab Emirates)	6 (6)	5 (5)	3 (3)	
Dr. Khalid Bin Abdulla Al-Sweilem (Saudi Arabian Monetary Agency)	6 (6)	5 (5)		2 (2)
Dr. Abdul Rahman Bin Ahmed Al-Jafary { attended first meeting as Board member on 8th October 2005 } (Saudi Arabian Monetary Agency)	2 (2)		0 (1)	1 (1)

* Committee Chairman

Figure in brackets indicate maximum number of meetings during the period of board membership.

CORPORATE GOVERNANCE continued

MANDATES OF THE BOARD COMMITTEES

The committees of the Board of Directors derive their authorities and powers from the Board.

Audit Committee:

- Assists the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices.
- Assists the Board in its oversight of (i) the integrity and reporting of the Bank's quarterly and annual financial statements, (ii) compliance with legal and regulatory requirements; and (iii) the independence and performance of the Bank's internal and external auditors.
- Recommends to the Board the selection and compensation of the Bank's external auditors (for appointment and approval at the shareholders' annual General Assembly), and ensures their independence.
- Reviews the activities, organisational structure and qualifications of the internal audit department.
- Maintains an open avenue of communication among the Board of Directors, the Bank's management and the Bank's internal and external auditors.

The function of the Audit Committee is oversight, and the mandate of the Audit Committee provides further particulars on financial reporting processes, process improvements, as well as additional ethical and legal compliance overview responsibilities.

The Group Chief Auditor reports functionally to the Audit Committee and administratively to the Chief Executive Officer.

The Head of Compliance, who reports to the Chief

Executive Officer, also has access to the Board of Directors through the Audit Committee, if required.

Risk Policy Committee:

- Reviews the Bank's risk policies and controls for consistency with the Bank's overall risk tolerance.
- Receives reports of any exceptions to risk policy.
- Reviews the Bank's risk profile and significant risk positions.
- Periodically reviews changes to the Bank's risk policies and limits.
- Periodically reviews changes to the Bank's risk processes and controls.
- Reports and makes recommendations to the Board on the Bank's risk profile, policies and controls.

Compensation Committee:

- Provides assistance to the Board in fulfilling its oversight responsibilities in matters relating to compensation structure and policy.
- Reviews and recommends to the Board the total Bank annual bonus pool.
- Recommends to the Board the CEO's compensation and annual bonus.

In line with industry best practice, the Bank has established a comprehensive staff compensation policy based on total compensation consisting of:

- A fixed component representing basic pay, allowances and benefits; and
- A variable component representing a performance-related award linked to the performance of the Bank, the contribution of the relevant unit and the individual's personal performance.

THE MANAGEMENT

Senior management, which is responsible for the day-to-day management of the Bank entrusted to it by the Board, is headed by the Chief Executive Officer, who is assisted by the Chief Operating Officer, responsible for risk management, financial controls, operations, administration, information technology, information security and operational risk, and three managing directors responsible for banking, merchant banking and treasury.

The following committees assist the Chief Executive Officer in the management of the Bank: Management, Group Risk, Bank ALCO (Assets and Liabilities Management) and Human Resources. The committees derive their authorities from the Chief Executive Officer, based on the authorities and limits delegated by the Board of Directors.

In fulfilling its principal responsibility of day-to-day management of the Bank, the management must implement Board approved policies and effective controls, within the strategy and objectives set by the Board.

STRATEGY & OBJECTIVES

After having conducted a thorough analysis of its operations in the context of the regional and global industry, in 2002 the Bank implemented improvements to its governance structure, organisational structure, business model and performance framework, and started to put into effect its new strategy and objective: *to become the GCC merchant bank of choice, with market leadership in a diversified portfolio of activities.*

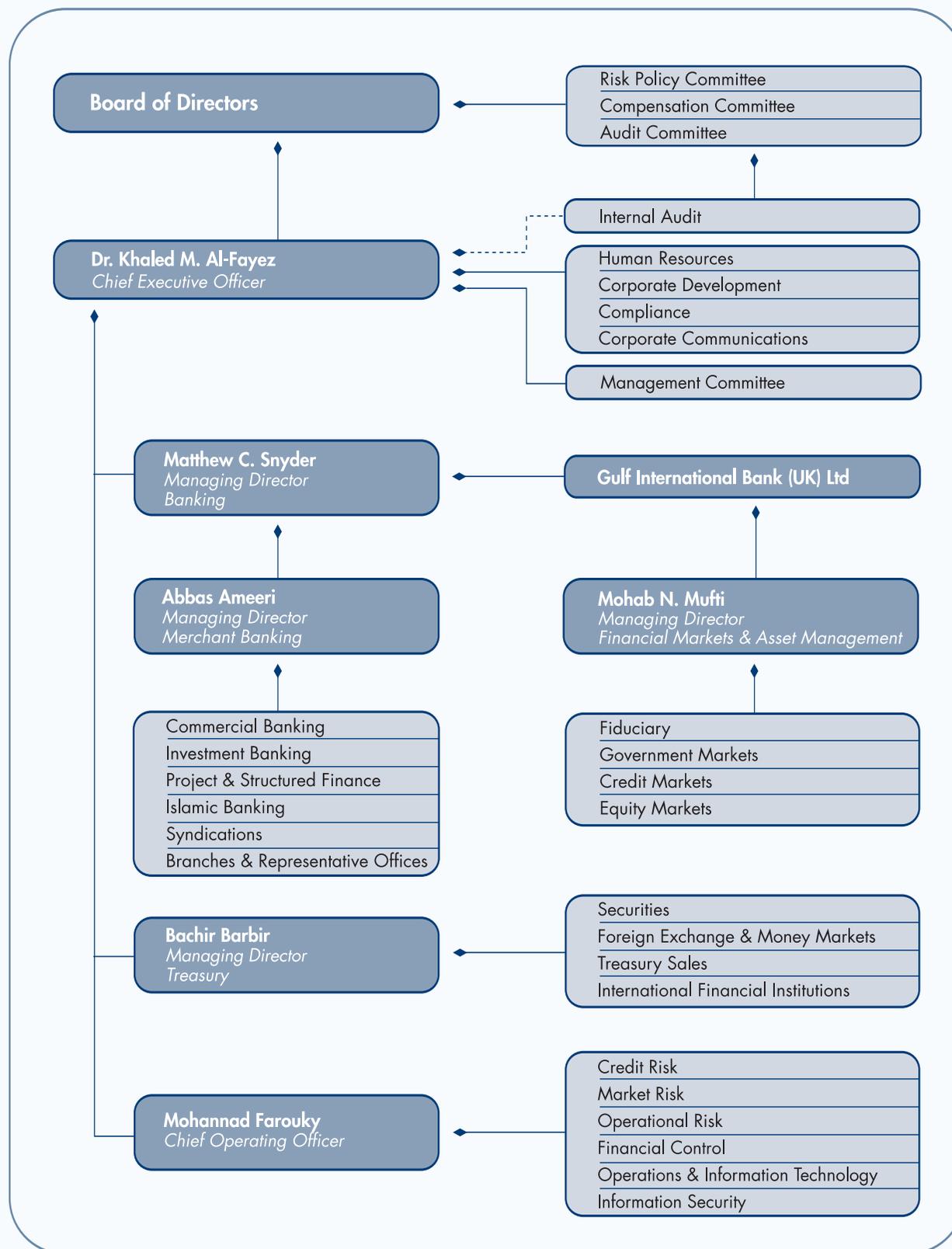
In keeping with good governance and transparency standards, the Bank has publicised its strategy and objectives on its website and in its Annual Reports.

DISCLOSURES & WEBSITE

The Bank's Annual Reports are also published on the Bank's website, and all the information contained in these reports is therefore accessible globally. That information includes management discussion on the business activities of the Bank, as well as discussion and analysis of the financial statements and risk management. The financial information reflects the latest international accounting standards requirements, including the amendment of the methodology for determining portfolio provisions, from an expected loss to an incurred loss basis, and the disclosure of the compensation of the Board of Directors and executive officers.

The Bank's website (www.gibonline.com) also provides substantial information on the Bank, including all its press releases.

ORGANISATION CHART



BIOGRAPHIES OF THE BOARD AND SENIOR MANAGEMENT

BOARD OF DIRECTORS

Sheikh Ebrahim Bin Khalifa Al Khalifa

Chairman

Bahraini Citizen

LLB, Beirut Arab University, Lebanon. Sheikh Ebrahim was appointed as Chairman of the Board of Directors in 2001. Since 1993, he has been Undersecretary at the Ministry of Finance & National Economy, Kingdom of Bahrain. Previously, he served as Deputy Governor of the Bahrain Monetary Agency from 1983-1993, Assistant to the Governor of the BMA from 1981-1983, and Head of Banking Control Department between 1975-1981. Other current positions include Chairman and Managing Director of Gulf Aluminium Rolling Mill Company (GARMCO), Chairman of Bahrain Development Bank and Bahrain Institute of Technology and Member of the Board of Aluminium Bahrain (ALBA) and Faysal Islamic Bank of Egypt.

Mr. Abdul Aziz M. Al-Abdulkader

Vice Chairman

Saudi Arabian Citizen

BA in Business Administration, the University of Washington, USA. Mr. Al-Abdulkader was appointed to the Board in 2001. He is Chairman of the Risk Policy Committee. He is the founder and owner of the AMA Group of Companies in Saudi Arabia. Mr. Al-Abdulkader is also the Chairman of Osool Capital. Other current directorships include Middle East Capital Group, United Gulf Industries Company and National Instalment Company Ltd. He is a former Chairman of the Board of Directors of Bank Al-Jazira.

Mr. Bader Abdulla Al Rushaid Al-Bader

Kuwaiti Citizen

BA in Commerce, Alexandria University, Egypt. Mr. Al-Bader was appointed to the Board in 1978. He served as Chairman and Managing Director of Kuwait Investment Company from 1992-2000. He was Deputy Managing Director of Kuwait Investment Authority from 1984-1992. He worked in various positions at the Ministry of Finance & Oil, Kuwait, from 1969 to 1984. Mr. Al-Bader has served as Chairman and Director of a large number of Middle Eastern financial institutions.

Dr. Hamad Bin Sulaiman Al-Bazai

Saudi Arabian Citizen

BA in Administrative Sciences, King Saud University, Saudi Arabia, MS and Ph.D. in Economics, Colorado State University, USA. Dr. Al-Bazai was appointed to the Board in 1999. He is Deputy Minister of Finance for Economic Affairs at the Ministry of Finance, Kingdom of Saudi Arabia. He is a Member of the Preparatory Committee of the Supreme Petroleum Council and a Board Member of the Human Resources Development Fund, the Southern Region Cement Company and the Higher Education Fund.

Mr. Saud Bin Nassir Al-Shukaily

Omani Citizen

BS in Business Administration, University of South Carolina, and MA in Development Management, American University, Washington, DC. Mr. Al-Shukaily was appointed to the Board in 1999. He is currently the Secretary General for Taxation at the Ministry of Finance, Sultanate of Oman. Earlier he served as Director General of Revenue and Investment at the Ministry of Finance (1996-2004), Director of the Minister's Office at the Ministry of Civil Services (1994-1996) and at the Ministry of National Economy (1996-1999). He is also Chairman of the Board of Directors of Oman Telecommunication Company, Vice Chairman of the Board of Directors of Oman Airport Management Company, Vice Chairman of the Board of Directors of the Oman Refinery Company and Member of the Board of Directors of the Sohar Industrial Port Company.

Dr. Khalid Bin Abdulla Al-Sweilem

Saudi Arabian Citizen

BS in Industrial Engineering, University of Arizona, MA in Economics, Boston University, Ph.D. in Economics, University of Colorado-Boulder, in addition to post-doctoral fellowship in Economics at Harvard University, USA. Dr. Al-Sweilem was appointed to the Board in 2004. He is now Director General of Investment at the Saudi Arabian Monetary Agency (SAMA). Previous positions at SAMA included Deputy Director General of Investment and Director Investment Management Department.

Mr. Khalid Bin Abdulla Al-Suwaidi

Qatari Citizen

BA in Accounting from South Eastern University, United Kingdom. He joined the Board in 2004. He has been the Office Director at the Deputy Secretary General's Office of the Supreme Council for Economic Affairs and Investment in Qatar since 2003. He served earlier as Director of Finance at the Airport Public Corporation (1997-2003).

Mr. Nasser Khamis Al-Suwaidi

UAE Citizen

BS in Business and Banking, Arizona University, USA, in addition to specialised courses in macroeconomics at the International Monetary Fund. He joined GIB's Board in 2004. Currently he is the Director of Industrial Development at the Ministry of Finance and Industry in the UAE. Previous positions at the ministry included Director of Investments (2003-2004), Minister's Office Manager (2000-2003), Head of Development Institutions-Investment Department (1999-2000). Mr. Al-Suwaidi is a Board member at OPEC Fund for Development and a Member of the UAE Anti-Dumping Committee and the Central Committee for Statistics Coordination.

Dr. Abdul Rahman Bin Ahmed Al-Jafary

Saudi Arabian Citizen

Bachelor of Science in Geology, University of Washington, Seattle, USA, Master of Science in Educational Administration from East Texas State University, and a Ph.D. in Business Administration from the University of Oklahoma. He joined GIB's Board of Directors in 2005. Mr. Al-Jafary started his career as Administrative Assistant to the Dean of the College of Petroleum & Minerals in the Kingdom of Saudi Arabia, and worked as a teaching assistant at the University of Oklahoma. He joined King Fahd University of Petroleum and Minerals as Assistant Professor and Associate Professor between 1979-1985. He also served as Dean of the College of Industrial Management between 1985-1989. Mr. Al-Jafary was appointed Secretary General of the Gulf Organisation for Industrial Consulting in 1989, where he served for 10 years. He was selected as a member of the Saudi Arabian Shura Council in 1993 and held this post until 2005. During this period he served as Chairman of the Finance Committee for four years. He is a member in the Academy of Management, in addition to his membership of the Board of Directors of the Saudi Arabian Mining Company and Dar Al Youm Press and Publishing. He has numerous published researches and lectures.

- ① Audit Committee Member
- ② Compensation Committee Member
- ③ Risk Policy Committee Member

BIOGRAPHIES OF THE BOARD AND SENIOR MANAGEMENT continued

SENIOR MANAGEMENT

Dr. Khaled M. Al-Fayez

Chief Executive Officer
Saudi Arabian Citizen

BA in Economics, Whitman College, Washington State, USA; MA in International Relations, MA in Law & Diplomacy and Ph.D. in Economics & International Relations, Fletcher School of Law & Diplomacy, which is run by Tufts University in cooperation with Harvard University, USA. Dr. Al-Fayez was Group Chief Executive Officer of Gulf Investment Corporation from 1983 to 2001. Dr. Al-Fayez served as GIB's first General Manager from 1976 to 1983. He was previously an Economic Advisor at the Saudi Arabian Ministry of Finance and National Economy and an Economist and Senior Credit Officer at the Saudi Industrial Development Fund. Dr. Al-Fayez is Chairman of the Board of Gulf International Bank (UK) Ltd., Member of the Advisory Council and Member of the Privatisation Committee of the Supreme Economic Council, Saudi Arabia, Member of the Advisory Board of The Middle East Institute, Washington, USA and former Member of the Board of the Institute of International Finance, Inc., Washington, USA.

Mohannad Farouky

Chief Operating Officer
UK Citizen

BA in Economics, the American University, Cairo and MBA in Finance, the University of Miami, USA. Prior to his recent appointment as COO, Mr. Farouky served as Managing Director-Risk Management from 2003-2004. From 2000 until 2002, he was assigned to Gulf International Bank (UK) Ltd. as Deputy Managing Director. From 1994 to 2000, he was Global Head of the Banking Group. Mr. Farouky joined GIB in London in 1986 as Head of the Europe and Africa Area. He is a member of the Board of Directors of Gulf International Bank (UK) Ltd. Before joining GIB, he worked at Citibank N.A. in the Middle East in a variety of credit and marketing positions, and at Chase Investment Bank Ltd. in London as a Managing Director.

Matthew C Snyder

Managing Director - Banking
US Citizen

BA in Political Science, CW Post College, USA and MA in International Politics, Long Island University, USA. Mr. Snyder first joined GIB's principal subsidiary Gulf International Bank (UK) Ltd. (then Saudi International Bank) in 1993. From 1982 to 1993 he was President and Chief Executive Officer of AI International, a US-based diversified, private industrial company. He previously worked for eleven years in the New York offices of Schroders, a London-based merchant bank. He is Managing Director of Gulf International Bank (UK) Ltd.

Bachir Barbir

Managing Director - Treasury
Lebanese and Canadian Citizen

Degree in Banking Studies and Business Administration from Saint Joseph University, Beirut, Lebanon. Mr. Barbir was appointed Assistant General Manager, Assets and Liabilities Management in 1997. In 1988 he was promoted to Executive Vice President and Head of the Assets and Liabilities Group. He was previously the Bahrain Treasurer. Mr. Barbir joined GIB in 1981. Before joining GIB he worked for Chase Manhattan Bank in both Bahrain and Lebanon and Credit Hypothecaire in Lebanon.

Abbas Ameer

Managing Director-Merchant Banking
Bahraini Citizen

Mr. Ameer has a banking experience of 22 years at GIB, where he worked within the credit and banking groups. He is responsible for GIB's total relationship efforts within the GCC, including ministries of finance, government agencies, corporations, financial institutions and investment companies. He also supervises other activities, including project and structured finance, syndications and Islamic banking, as well as the activities of GIB's branches in Riyadh, Jeddah, London and New York and the two representative offices in Abu Dhabi and Beirut. Mr. Ameer is a member of GIB's Management Committee, the Credit Committee and the Assets and Liabilities Committee.

Mr. Mohab Naji Mufti

Managing Director -
Financial Markets and Asset Management
Saudi Arabian Citizen

B.Sc in Computer Science, University of East Anglia, UK. Mr. Mufti is Deputy Managing Director and Executive Board Member of Gulf International Bank (UK) Ltd. He has been responsible for GIB's Financial Markets business since 1999. He joined Gulf International Bank (UK) Limited in 1996. Prior to that Mr. Mufti worked with the National Commercial Bank in Saudi Arabia, where he was the Head of Trading. Between 1987 and 1993 he occupied various senior trading and investment roles within Saudi International Bank in London. Mr. Mufti is a Board Member of the Arab Bankers Association, UK.

CORPORATE DIRECTORY

General Management

Dr. Khaled M. Al-Fayez

Chief Executive Officer

Mohannad Farouky

Chief Operating Officer

Matthew Snyder

Managing Director - Banking

Bachir Barbir

Managing Director - Treasury

Abbas Ameer

Managing Director - Merchant Banking

Mohab N. Mufti

Managing Director -

Financial Markets & Asset Management

Merchant Banking

GCC Commercial Banking**Ali Rahimi**

Head of Bahrain, Kuwait and

Saudi Arabia

Srinivas Vemparala

Head of Oman, Qatar & UAE

Project & Structured Finance**M. Chandrasekaran**

Head of Project & Structured Finance

Rajan Malik

Syndications

Masood Tyabji

Islamic Banking

Gary Griffiths

Asset Trading & Loan Agency

International Banking**Peter Szalay**

Head of International Banking

Asghar Ali Baba

Near & Far East

Investment Banking**Salman Al-Deghaither**

Head of Investment Banking

Bashar Kayyali

Corporate Finance - Saudi Arabia

Abdul Qaiyum

Corporate Finance - Abu Dhabi

Salman Chaudhry

Corporate Finance - Bahrain

Fakhre Fazli

Corporate Finance - Bahrain

Financial Markets & Asset Management

Fiduciary**Mohab Mufti**

Head of Fiduciary

Aftab Hussain

Fund Products

Equity Markets

Uday Patnaik

Head of Equity Markets

Paul Harrison

Equity Trading

Axel Lomholt

Equity Portfolio Management

Government Markets**Anthony Chisnall**

Emerging Markets

Charles Thomson

Bond Portfolio Management

John Benfield

G10 Markets

Credit Markets**Alex Veroude**

Head of Credit Markets

Uli Gerhard

Corporate Debt - Investment Grade

Azhar Hussain

Corporate Debt - High Yield

Andrew Burgess

Asset Backed Securities

Private Equity**Gregga Baxter**

Head of Private Equity

Treasury

Souheil Hajjar

Head of Investments

Adel Al-Dosseri

Head of Foreign Exchange &

Money Markets, Bahrain

Adnan Al-Rifaie

Riyadh Treasury

Steven Moulder

Head of London &

New York Treasury

Salman Al-Zayani

Head of Treasury Sales

Ali Al-Qaseer

International Financial Institutions

Austin Sequeira

Treasury Policy & Administration

Corporate Development

Fouad J. Masrieh

Head of Corporate Development

Corporate Communications

Abdulla Naneesh

Head of Corporate Communications

Board Secretariat

Faiz Al-Barwani

Secretary to the Board

Risk Management

Masood Zafar

Chief Credit Officer

Stephen Williams

Group Financial Controller

Paul Waine

Chief Financial Officer - GIBUK

Jameel Al-Sairafi

Information Security - Bahrain

Shane Panjavani

Operational Risk - Bahrain

Support Functions

Abdulla Janahi

Head of Operations &

Information Technology

Ali Buhejji

Operations - Bahrain

Ali Ashoor

Administration - Bahrain

P. K. Nambiar

Information Technology

Gordon Brooker

Operations & Administration -

GIB UK

Rashed Abdul-Rahim

Operations & Administration -

Riyadh Branch

Human Resources

Hassan Abdul-Ghani

Head of Human Resources

Jamal Hijris

Human Resources - Bahrain

Emad Nabulsi

Human Resources - Riyadh Branch

Debbie Brooks

Human Resources - GIBUK

Audit, Legal & Compliance

Hassan Al-Mulla

Group Chief Auditor

Julian Anthony

Audit - London

Georges Djandji

Head of Compliance - Bahrain

Dominic Bacon

Legal & Compliance - London

Sally Wells

Company Secretary - GIBUK

CORPORATE DIRECTORY continued

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Treasury: (+973) 17 522530
Investments: (+973) 17 522629
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International Money Market Unit/
Middle East Currency: GIBF
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Internet
http://www.gibonline.com

Principal Subsidiary

Gulf International Bank (UK) Limited

Matthew C. Snyder
Managing Director &
Chief Executive Officer
Mohab N. Mufti
Deputy Managing Director
One Knightsbridge
London SW1X 7XS
United Kingdom
Telephone
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Telefax
(+44) 20 7259 6060
Telex 8812261/2
Cables SAUDIBANK
LONDON SW1
S.W.I.F.T: SINTGB2L

Branches

KSA Branches

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