GiB

بنك الخليج الدولي

Annual report 2017

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GIB
بنـك الخليـج الدولـي

Gulf International Bank

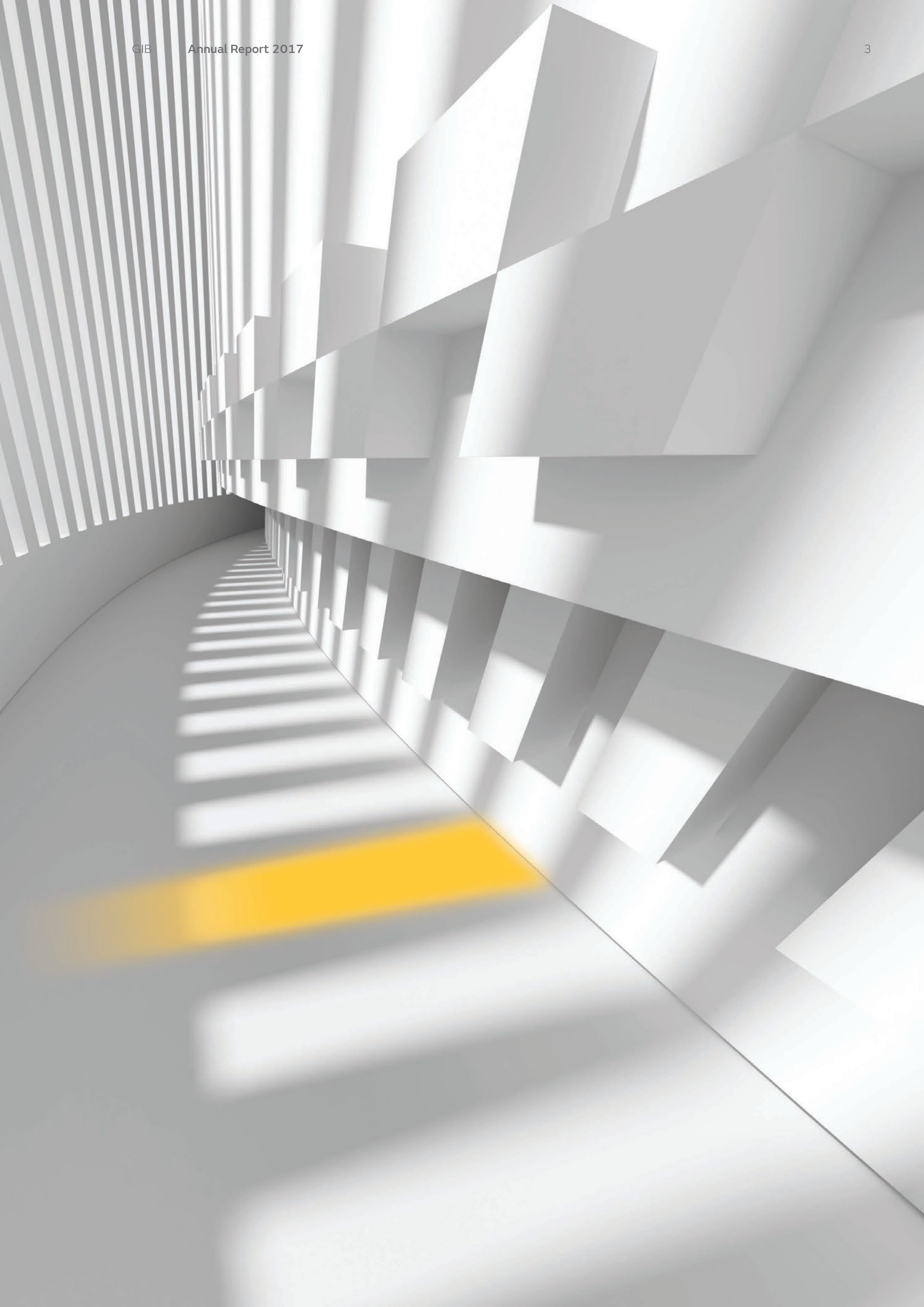
Gulf International Bank B.S.C. (GIB) was established in the Kingdom of Bahrain in 1975, and commenced operations in 1976. In 2017, GIB became the first foreign domiciled bank to be granted approval from the Saudi Arabia Council of Ministers to establish a local commercial bank in the Kingdom of Saudi Arabia. Consequently, GIB's branch offices in the Kingdom will become part of the Saudi Arabian subsidiary, with the country headquarters located in Dhahran.

GIB is owned by the governments of Gulf Cooperation Council countries, with Saudi Arabia's Public Investment Fund being the primary shareholder.

GIB aims to be the preferred financial services partner, delivering bespoke banking solutions to a wide customer base in the region and beyond. This includes corporate banking, the world's first Shariah-compliant digital retail banking service, 'meem' by GIB and investment banking through its fully owned subsidiary GIB Capital.

GIB Capital is the investment banking arm of GIB, offering innovative solutions in the fields of asset management, bond and Sukuk issuance, financial restructuring, private placements, private sale, IPOs, underwriting equity and debt, as well as mergers and acquisitions.

In addition to its main subsidiaries, London-based GIB (UK) Ltd., and Riyadh-based GIB Capital, GIB has branches in London, New York, Abu Dhabi, Dhahran, Riyadh and Jeddah with a representative office in Dubai.



A UNIQUE AND ENDURING LEGACY

His Excellency Jammaz Bin Abdullah Al-Suhaimi

Chairman of Gulf International Bank

From May 2008 to November 2017

Widely recognised as a paragon of leadership and a champion of change, His Excellency Jammaz bin Abdullah Al-Suhaimi was that rarest of men – a legend in his own lifetime. With his clear moral compass and personable nature, Jammaz (as he preferred to be known) touched the hearts and minds of all those he came into contact with. Exhibiting all the traits of a great leader, he was a true visionary and innovator, with strong strategic foresight and business acumen.

Career Highlights

The professional career of Jammaz bin Abdullah Al-Suhaimi spanned more than 45 years, and embraced senior positions in both government institutions and private sector companies. During his time with the Saudi Arabian Monetary Authority (SAMA), Jammaz successfully strengthened the supervisory framework, governance standards and technological infrastructure of the Saudi banking system. Initially appointed as Director General for Banking Control in 1984, he became Deputy Governor in 1989.

As the first Chairman and CEO of the Saudi Capital Market Authority (CMA) in 2004, Jammaz spearheaded the development of a properly regulated capital market in Saudi Arabia, underpinned by a new benchmark for acceptable market practice and ethical behaviour, and paving the way for the establishment of Tadawul in 2007. He also guided the introduction of the Kingdom's Corporate Governance Code.

Appointed Chairman of Gulf International Bank in 2008, Jammaz will be remembered as the architect of GIB's new sustainable business model and strategy, designed to transform it into a leading pan-GCC universal bank. Adopting a bold and proactive approach to mitigate the impact of the global financial crisis on GIB, he guided the de-risking and stabilisation of the balance sheet, and return of the Bank to profitability.

Personal tributes

Dr. Abdullah bin Hassan Alabdulgader, Chairman of GIB, worked closely with him since 2009 as a Board member and then Vice Chairman. Dr. Alabdulgader recalls his relationship with him saying: "I first came into contact with Jammaz in 2004, when I was appointed as a member of the first Board of the CMA. As the first Chairman and CEO of the CMA, Jammaz worked fearlessly to enforce the new market rules regardless of the consequences of how it might affect his personal relationships with those major players infringing the rules. All the people who worked with him, including myself, found his unique leadership style to be highly refreshing and motivating, and I learned so much from him."

According to Dr. Yahya A. Alyahya, who was Chief Executive Officer of GIB from January 2009 to January 2016 and a Board Member since 2015, Jammaz was "a true legend, with a unique number of positive traits and skills rarely found in the same person. My association with Jammaz began in 1989 when as Deputy Governor of SAMA, he entrusted me with the task of establishing a new Institute of Banking. Had he played chess, he would surely have been a grandmaster, always many steps ahead of everyone else, with his eyes set firmly on the end game. He was a true icon."

Mr. Abdulaziz A. Al-Helaissi, who took over as Group Chief Executive Officer of GIB in February 2016, came to know Jammaz first as a regulator, and then as a chairman and mentor. "A true visionary, he really stood out as a leader, innovator and strategic thinker. He was very clear about the next chapter in GIB's strategic and business evolution, and determined to preserve the integrity and reputation of the Bank. I will miss his invaluable counsel, his unique out-of-the-box approach to business, and his wonderful sense of humour."

Two of GIB's longest-serving employees were the only members of the Executive Management team to have worked with Jammaz Al-Suhaimi throughout his tenure as Chairman of the Bank.

Group Chief Risk Officer Masood Zafar (who joined GIB in 1982) describes Jammaz as: "Highly respected for his integrity and shrewdness, and his tremendous vision. He was a firm advocate for a strong risk management framework and culture throughout GIB, and across the regional banking industry. I consider myself fortunate to have known him."

According to Group Chief Financial Officer Stephen Williams (with GIB since 1987), Jammaz was: "Pioneering and innovative but also very practical, with exceptionally high standards. He had a true passion for the Bank, and its success was really important to him personally. It was a rare privilege to have worked with him."

Enduring legacy

As these tributes illustrate, the enduring legacy of Jammaz bin Abdullah Al-Suhaimi encompasses his outstanding and pioneering contribution to the regional financial services industry; together with providing unique lessons in leadership, and setting an example for personal integrity. His achievements have provided a solid financial and institutional base through which to support the ongoing implementation of Saudi Arabia's Economic Vision 2030 and National Transformation Plan 2020; and will also have far-reaching socio-economic benefits for the entire GCC region. In decades to come, this will likely prove to be the most important legacy that Jammaz left behind.

Board of Directors

Dr. Abdullah bin Hassan Alabdulgader
Chairman
Kingdom of Saudi Arabia

Mr. Khaled bin Saleh Al-Mudaifer
Vice Chairman
President and CEO
Ma'aden (Saudi Arabian Mining Company)
Kingdom of Saudi Arabia

Mr. Abdulla bin Mohammed Al Zamil
Director
Kingdom of Saudi Arabia

Mr. Omar Hadir Al-Farisi
Director
United States of America

Dr. Yahya A. Alyahya
Director
Kingdom of Saudi Arabia

Mr. Abdulaziz A. Al-Helaissi
Director
Group Chief Executive Officer,
Gulf International Bank
Chairman, Gulf International Bank (UK) Limited
Kingdom of Saudi Arabia

Financial highlights

	2017	2016	2015	2014	2013	2012
Earnings (US$ millions)						
Net income after tax	**70.0**	37.3	90.4	85.6	121.5	117.9
Net interest income	**253.1**	190.0	188.2	158.0	163.1	149.4
Fee and commission income	**72.6**	66.2	70.2	62.9	62.0	56.7
Operating expenses	**240.0**	219.0	192.1	164.9	151.6	136.1
Financial position (US$ millions)						
Total assets	**25,471.3**	22,905.8	24,192.4	21,300.2	21,156.9	17,704.8
Loans	**10,043.1**	9,745.1	9,161.4	7,931.5	8,317.2	7,110.3
Investment securities	**3,993.8**	4,066.4	3,884.5	3,944.5	3,725.8	3,560.1
Senior term financing	**3,263.6**	2,761.6	2,420.0	3,372.9	2,332.9	2,432.7
Equity	**2,410.9**	2,357.4	2,431.0	2,350.7	2,264.0	2,130.2
Ratios (per cent)						
Profitability						
Return on average equity	**2.9**	1.6	3.8	3.7	5.5	5.8
Return on average assets	**0.3**	0.2	0.4	0.4	0.6	0.7
Capital						
Risk asset ratio (Basel 2)						
- Total	**15.6**	16.8	17.8	19.6	18.9	20.1
- Tier 1	**14.7**	15.7	16.8	18.1	16.9	17.4
Equity as % of total assets	**9.5**	10.3	10.0	11.0	10.7	12.0
Asset quality						
Securities as % of total assets	**16.4**	18.2	16.4	18.9	17.9	20.7
Loans as % of total assets	**39.4**	42.5	37.9	37.2	39.3	40.2
Liquidity						
Liquid assets ratio	**58.3**	55.0	60.0	60.9	58.8	57.9
Deposits to loans cover (times) [1]	**2.1**	1.9	2.1	2.2	2.1	2.0

[1] Deposits include senior term financing

CREDIT RATINGS

	Fitch	Moody's Ratings	Capital Intelligence
Long-term Deposit Rating	BBB+	Baa1	A+
Long-term Senior Unsecured Debt Rating	BBB+	Baa1	-
Short-term Deposit Rating	F2	P-2	A1
Viability	bbb-	-	-
Financial Strength	-	-	BBB+
Outlook	Stable	Negative	Negative

Chairman's statement

On behalf of the Board of Directors, it is my pleasure to present the annual report of Gulf International Bank (GIB) for the fiscal year ended 31st December 2017. This year proved to be even more demanding than expected, marked by continued economic and market volatility; a challenging banking sector; and heightened geo-political tensions. Against such a backdrop, I am pleased to report that the Bank posted a robust overall performance.

Financial results

GIB achieved a considerably-improved financial performance for 2017, highlighted by significant increases in both gross and net income, and a stronger funding profile. Gross income increased by 20 per cent to US$360.3 million compared with US$300.0 million in the previous year, with all business lines posting higher revenue contributions. Net interest income grew by US$63.1 million or 33 per cent to US$253.1 million, reflecting the growth in loan volumes and improved loan margins during 2017. Fee and commission income, which is the largest contributor to non-interest income, increased by US$6.4 million or 10 per cent to US$72.6 million, with higher fee-based income from asset management and trade finance activities.

Total operating expenses grew by 10 per cent to US$240.0 million in 2017 from US$219.0 million in the previous year. The increase is principally attributable to the depreciation and maintenance of information technology assets. In view of prevailing economic and market conditions, we took the prudent decision to make a conservative provision charge of US$43.7 million in 2017 versus US$38.6 million in the previous year. Accordingly, net income for 2017 grew by 88 per cent to US$70.0 million compared with US$37.3 million a year earlier, reinforcing our strategic intent to sustainably grow the profitability of the Bank.

Encouragingly, this was the first year since the implementation of GIB's new business strategy in 2011 that gross income grew at a higher rate than expenses; while the cost-to-income ratio improved by 6 percentage points during the year. It is also worth noting that the quality of income improved in 2017, with less income of an exceptional or non-recurring nature than in prior years. In addition, against a backdrop of subdued growth in the market during 2017, the percentage increases in both gross and net income achieved by GIB, compared favourably with its peers.

Return on equity almost doubled in 2017, but remains modest. We expect this to continue in the short term as we continue to focus on building GIB for the future. However, following the expected breakeven of the new retail bank 'meem', we envisage returns to improve significantly.

GIB continued to maintain a strong balance sheet in 2017. Consolidated total assets at the end of the year stood at US$25.5 billion, an increase of 11 per cent from US$22.9 billion at the end of 2016, with the asset profile reflecting a high level of liquidity. Cash and other liquid assets, and short-term placements, increased by 26 per cent to US$10.7 billion

Dr. Abdullah bin Hassan Alabdulgader
Chairman
Kingdom of Saudi Arabia

from US$8.4 billion in 2016, and represented 42 per cent of total assets. Placements with banks exceeded deposits from banks, with GIB continuing to be a net lender to the interbank market. Loans and advances in 2017 grew by 3 per cent to US$10.1 billion compared with US$9.7 billion at the previous year-end.

GIB's strongly-improved financial performance illustrates that we are beginning to realise the benefits of our investments in recent years. These include the establishment of GIB's new digital retail banking proposition 'meem', expansion of the asset management business, enhancements to our human capital and information technology infrastructure, and new offices across Saudi Arabia and the UAE. It also reflects the success of the Bank's strategic focus on expanding and diversifying revenues, minimising expenses, and improving operational efficiency.

Funding position
GIB's funding derives primarily from corporate customer deposits, which increased by 19 per cent in 2017 to US$16.0 billion, accounting for 88 per cent of total deposits and exceeding loans and advances by more than 1.5 times. GIB successfully raised new senior term financing during the year through the issuance of an attractively-priced US$500 million long five-year bond in January, which was more than two times oversubscribed. Significantly, the Bank was the first non-sovereign entity in Central and Eastern Europe, the Middle East and Africa (CEEMEA) to issue a bond in 2017, establishing a US Dollar benchmark for global investors to follow in the MENA region.

GIB's robust funding position demonstrates the ongoing confidence of our clients and counterparties; and confirms the Bank's commitment to expand and diversify its funding sources, and utilise different structures to achieve an equitable cost of funding. These include securing cheaper and more stable funding through retail and transactional banking activities; and diversifying revenues away from lending and use of the balance sheet through greater contributions from treasury, investment banking and asset management. At the end of 2017, GIB's Basel 3 total and tier 1 capital adequacy ratios were a strong 15.6 per cent and 14.7 per cent, respectively.

Ratings confirmation
The international rating agencies again endorsed their confidence in GIB's financial strength during 2017. In December, Fitch Ratings affirmed the Bank's long-term issuer default rating (IDR) at BBB+ and bbb- viability rating (VR); while Capital Intelligence Ratings affirmed GIB's long- and short-term foreign currency ratings (FCRs) at A+ and A1, respectively. In November, Moody's Investors Service re-affirmed GIB's prime-2 short-term rating and Baa1 long-term deposit rating. The agencies highlighted the high probability of support from the Bank's long-standing majority shareholder; prudent underwriting standards and good risk controls; stable asset quality and comfortable liquidity buffer; and sound overall strategic re-orientation.

Given the current economic climate and challenging market conditions, these rating confirmations are important independent validations of our continued financial strength, and the success of actions we have taken in recent years to transform the Bank through the implementation of our new business strategy. Additional recognition of GIB's business achievements took the form of further industry awards during the year. These confirm the Bank's enduring strength, stability and reputation in the face of a highly-competitive and rapidly-changing financial landscape.

Strategic progress
I am pleased to report that implementation of the Bank's strategy continued to gain positive momentum during 2017, underlined by significantly improved collaboration across the organisation. Particular progress was made in the key strategic focus areas of revenue diversification, funding profile, and operational and cost efficiency; supported by enhancements to the Bank's human capital, information technology and governance infrastructure.

Notable strategic developments include approval from the Council of Ministers for a local banking licence in the Kingdom of Saudi Arabia. The new subsidiary will incorporate GIB's branches in Riyadh, Dhahran and Jeddah; and digital retail banking activities under the 'meem' brand. GIB was also granted a conventional retail banking licence by the Central Bank of Bahrain, which will be seen to encourage the development of the fintech industry in the Kingdom of Bahrain. With new clients being able to open accounts online, 'meem' Bahrain will be one of the first fully-digital retail banks in the region. Both these achievements constitute important milestones in GIB's strategy to become a full-fledged pan-GCC universal bank. I take this opportunity to express my deep appreciation and thanks to the leaderships in the Kingdom of Saudi Arabia and the Kingdom of Bahrain. Gulf International Bank will continue its deep commitment to the highest professional standards to support the regional economy.

Chairman's statement (continued)

Institutional capability
During 2017, we continued to strengthen GIB's institutional infrastructure in order to support the realisation of our strategy and continued business growth. In this respect, we significantly enhanced our human capital through the recruitment of high-calibre professionals across a range of disciplines. We also continued to invest in systems to both streamline back office operations and improve cost efficiencies; together with diversifying the products and services offered by the Group. In addition, we strengthened the Bank's corporate governance and risk management frameworks to comply with the latest regulatory requirements; and ensure that GIB remains robust and resilient in the face of increasingly volatile economic and market conditions.

Change in leadership
It is with deep sorrow and regret that I report the sad demise of H.E. Jammaz bin Abdullah Al-Suhaimi in November 2017. A visionary leader who cared passionately about GIB, Jammaz was Chairman of the Board for almost a decade. He will be remembered as the architect and driver of the Bank's new strategy and sustainable business model following the global financial crisis. His extensive experience and unrivalled knowledge of the regional banking industry was invaluable in guiding the Board and Management in executing the Bank's vision and ongoing strategic direction. Jammaz will be sorely missed, and I am conscious that it will be a highly challenging task to follow in his footsteps. It is an honour to have been elected the new Chairman of the Board, and I am pleased to welcome Mr. Khaled bin Saleh Al-Mudaifer as the new Vice Chairman.

Looking ahead
With the global economy continuing to expand, the outlook for 2018 remains positive. However, there are expectations of increased volatility across financial markets as central banks continue to reduce their stimulus measures. Although economic conditions in the GCC remained strained in 2017, the recovery in oil prices during the second half of the year has led to an improvement in regional prospects for 2018. GCC countries have continued to respond proactively to a low oil price regime with comprehensive economic and fiscal reform programmes.

The outlook for the regional banking sector remains stable, supported by its strong underlying fundamentals. It is expected to benefit from the ongoing stabilisation of oil prices, a more resilient non-oil sector, and generally positive economic growth trends. As such, we are quietly optimistic about the prospects for GIB in 2018. The Board has full confidence in Management's ability to address all future challenges, and continue to meet our strategic objectives and ambitious business goals with integrity, professionalism, innovation and agility.

Acknowledgements
On behalf of the Board of Directors, I would like to express my sincere appreciation for the unwavering confidence and support of our shareholders; the enduring trust and loyalty of our clients; and the continued encouragement and cooperation of our counterparties. We are also grateful for the ongoing advice and guidance that we receive from the regulatory and supervisory bodies in the various jurisdictions under which GIB operates. I also take this opportunity to pay tribute to the commitment and professionalism of our management and staff; and their positive attitude towards embracing change and implementing the Bank's ongoing strategic and cultural transformation in another highly-challenging year.

Dr. Abdullah bin Hassan Alabdulgader
Chairman of the Board

OUR STRATEGIC FOCUS AREAS

- Increase & Diversify Revenue
- Deliver Effective Funding Profile
- Enhance Service Excellence & Quality
- Increase Operational & Cost Efficiency
- Become an Employer of Choice

OUR STRATEGIC PILLARS

1. Wholesale Banking
2. Investment Banking
3. Treasury
4. Asset Management
5. Retail Banking

SUPPORTED BY

- People
- Technology
- Governance

Management review

In what proved to be one of the most challenging years to date for the regional banking industry, I am pleased to report that GIB made excellent progress in pursuing its overall strategic objective to become a full-service pan-GCC bank. As this review illustrates, our progress was underlined by notable achievements across all key strategic focus areas. This has helped to further enhance GIB's financial strength, resilience and competitiveness, while upholding its enduring reputation and integrity.

INCREASING AND DIVERSIFYING REVENUES

GIB successfully increased its revenues during 2017. Wholesale banking, treasury, investment banking, asset management and retail banking activities all posted higher contributions to gross income, reflecting a greater level of cross selling and collaboration.

Revenue growth highlights

- Total income increased by 20 per cent to US$360.3 million compared with US$300.0 million in the previous year, with GIB's growth comparing favourably with its peers.
- Net interest income increased by 33 per cent from US$190.0 million to US$253.1 million, primarily reflecting the growth in loan volumes and improved margins during the year.
- Fee and commission income, which is the largest contributor to non-interest income, increased by 10 per cent to US$72.6 million (2016: US$66.2 million).

The Bank was also successful during the year in implementing its strategy to further diversify revenue streams away from lending activities and use of the balance sheet.

Revenue diversification highlights

- The online global transaction banking (GTB) platform, which comprises cash management and structured trade finance services, enjoyed a successful first full year of operations in 2017, with a 45 per cent increase in call and current accounts.
- GIB Capital, the Bank's Riyadh-based investment banking arm, introduced a new asset management division in 2017, which added a recurring annuity-based revenue stream.
- GIB Capital obtained regulatory approval to launch a new public opportunistic equity fund in 2018, and also received a brokerage licence from the Capital Market Authority (CMA).
- GIB was granted a conventional retail banking licence by the Central Bank of Bahrain. Retail banking activities in Bahrain are planned to commence in the first half of 2018.
- The re-orientation of the Financial Institutions Group as a revenue-generating relationship management team is expected to enhance contributions from 2018.

Mr. Abdulaziz A. Al-Helaissi
Group CEO and Board Member
Gulf International Bank

DELIVERING AN EFFECTIVE FUNDING PROFILE

Following exceptional market conditions in 2016, the cost of funding reverted to more normal levels in 2017, with the overall all-in average cost of funds premium dropping from 68 basis points in 2016 to 49 basis points in 2017. Against this more favourable backdrop, GIB's funding profile showed a marked improvement over 2016, with an increased focus on customer deposits and a further reduced reliance on interbank borrowing. The successful liabilities diversification initiative, including a new focus on longer-term funding derived from new customers, resulted in an enhancement in both depositor concentration and weighted average tenor.

Customer deposits, which provide the majority of GIB's funding, increased by 19 per cent to US$16.0 billion in 2017, accounting for 88 per cent of total deposits, and exceeding loans and advances by 1.6 times.

A growth in retail banking ('meem') and GTB deposits provided GIB with a more stable source of funding. The liabilities portfolio of 'meem' grew by almost 400 per cent to US$1.1 billion in 2017, accounting for 20 per cent of deposits in the Saudi Arabia branch.

The online cash management and structured trade finance services provided by GTB witnessed a significant uptake by clients in 2017. This was illustrated by total call and current accounts increasing by 45 per cent during the year.

The Bank successfully raised new senior term financing during the year through the issuance of an attractively-priced US$500 million long five-year bond in January. The order book was well diversified, with investors comprising banks, fund managers, insurance companies and other investors from MENA, Europe and Asia. The issue met with robust demand, peaking at over US$1.2 billion and allowing price guidance to be tightened to achieve a final pricing of 170 basis points over mid-swaps, which was 10 basis points less than the indicated initial price thoughts. Significantly, the Bank was the first non-sovereign entity in Central and Eastern Europe, the Middle East and Africa (CEEMEA) to issue a bond in 2017, establishing a US Dollar benchmark for global investors to follow in the MENA region.

BECOMING THE EMPLOYER OF CHOICE

In 2017, the Board approved GIB's new three-year Human Resources (HR) strategy, which is based on four key pillars (see panel below). Designed to achieve the Bank's aim of becoming the employer of choice in banking and financial services, the strategy focuses on learning and development, performance management, enhanced communications and employee engagement.

To support the effective implementation of its business strategy, GIB continued to strengthen its human capital during the year, recruiting highly-experienced and qualified professionals to fill key management positions across a range of disciplines. Priority was also placed on learning and development. New initiatives included the introduction of the GIB Academy, with a core curriculum covering leadership development and performance management, personal effectiveness, and technical and regulatory training.

In addition, the GIB Young Professional Development Programme was reviewed and further enhanced. The objective of this two-year programme, which was initiated in 2013, is to onboard the best newly-qualified graduates in the GCC, and provide them with an opportunity to develop into future leaders of the Bank.

Another key HR development involved the establishment of a Staff Engagement Working Group to manage and monitor staff engagement initiatives at a group and divisional level, assisted by a newly-appointed external engagement survey provider. To enhance staff motivation, the Rowad Awards & Recognition Programme was introduced. This comprises annual awards for exceptional performance, together with ad hoc recognition for staff exhibiting the GIB brand behaviours of perceptiveness, agility, collaboration and integrity.

Human resource strategy pillars

- Create an engaged and motivated workforce
- Establish a high-performance culture
- Build a strong GCC National capability for the future
- Develop an organisation that supports GIB's growth ambitions

Management review (continued)

IMPROVING OPERATIONAL AND COST EFFICIENCY

GIB's revised five-year Information Technology (IT) strategy was approved by the Board of Directors in 2017. Based on four key pillars (see panel below), the strategy aims to create self-organising collaborative and stable IT services, aligned to deliver business value, and with the agility to keep pace with the latest digital developments in global banking and technology. To ensure the effective implementation of the strategy, the IT division was restructured into four business-aligned and service-driven specialist units to deliver optimum value to GIB and its clients.

Key initiatives during the year included meeting new stringent regulatory requirements for cyber security, and providing new automated services for Human Resources, IT, Information Security, Administration and Procurement. In addition, a proof-of-concept pilot was conducted for the introduction of new robotics technology. Plans were also developed for the utilisation of latest technologies and techniques such as DevOps, Agile delivery, and Cloud-enabled test environments.

In a notable development – the first of its kind in the region – GIB moved its entire global IT network to a single service provider. The consolidation of 30 existing separate IT-related contracts has resulted in reduced costs and improved service level agreements. Additionally, plans have been approved for the construction of a new state-of-the-art centralised Group Operations Centre in the Eastern Province of Saudi Arabia in 2018.

Improved operational and cost efficiencies during the year led to a flattening of expenses, which increased by 10 per cent versus 14 per cent in 2016.

Information technology strategy pillars

- Stabilise the core in a secure and controlled environment
- Build for the future with the application of latest technologies
- Enhance efficiency with a focus on continuous improvement
- Align the IT function more closely to the needs of the business

ENHANCING SERVICE EXCELLENCE AND QUALITY

During 2017, GIB made strong progress on aligning people, products, processes and systems across the organisation in order to improve the quality of service provided to clients, and further enhance the overall 'customer experience'.

Wholesale Banking continued to implement its relationship-based strategy through the introduction of new innovative solutions. These include the online banking portal of the Global Transaction Banking proposition for convenient and secure cash management and structured trade finance. In addition, the transformation of the Financial Institutions Group to a relationship-based management team, will provide focused coverage for banks, government entities and other non-banking financial institutions. The Abu Dhabi branch and the Dubai representative office were moved to more high-profile and convenient locations, while credit workflow automation is in progress to improve the quality and efficiency of this vital process.

Retail Banking ('meem') enhanced its digital platform to provide clients with an improved seamless interface, and finalised plans for the launch of new asset products in 2018; while Investment Banking augmented its services with the receipt of regulatory approval to provide brokerage services.

Treasury expanded its analytics and customer solutions teams, and developed 25 new conventional and Shariah-compliant products to meet clients' growing needs for bespoke risk management and yield enhancement solutions. In addition, asset management services, which are provided collaboratively by GIB Capital and GIB (UK) Limited, were expanded to provide clients with new wealth management solutions, including the launch of new funds.

To support the business divisions in improving service excellence and quality, Information Technology increased the automation of operational processes and procedures; while Human Resources strengthened the Bank's talent base, developed employees' technical and people skills, and reinforced GIB's brand behaviours of perceptiveness, agility, collaboration and integrity.

PROTECTING AND ENHANCING REPUTATION

During the year, the Bank further strengthened its corporate governance and risk management frameworks in order to comply with the latest regulatory requirements; and provide protection against increasingly volatile economic and market conditions.

GIB also continued to implement its corporate social responsibility programme – WAGIB, and maintained its sponsorship of prominent regional and international industry conferences and events, through which to enhance its reputation.

Compliance developments

- Achieved high level of regulatory compliance in all operating jurisdictions.
- Enhanced focus on information sharing, client confidentiality and cyber security.
- Revamped all Know-Your-Customer (KYC) processes across the Bank, with anti-money laundering (AML) monitoring and analysis conducted on a daily basis.
- Achieved compliance with the EU Markets in Financial Instruments Directive (MiFID II).
- Implemented all required processes and systems to accommodate the introduction of VAT in both Saudi Arabia and the United Arab Emirates.
- Developed a comprehensive Compliance & Corporate Governance Programme for introduction in 2018, including the establishment of a new dedicated department.
- Conducted a wide-ranging Compliance training programme, covering critical areas such as Anti-Money Laundering, Code of Conduct and Insider Trading, and Conduct Risk.

Risk developments

- Recalibrated, optimised and validated Moody's Risk Analyst ratings model, based on actual borrowers' experience, and developed Group PDs (Probabilities of Default).
- Strengthened cyber security defences in line with new regulatory requirements.
- Expanded the Information Security team.
- Conducted annual review of GIB's risk framework against international best practice.
- Reviewed and strengthened credit policies and procedures in light of changing market conditions.

ADDRESSING FUTURE CHALLENGES

Prospects for the GCC region are at once challenging and exciting, characterised by both risks and opportunities in a time of unprecedented change. The region is in the midst of a major transition as it adjusts to a new economic paradigm, with many countries launching fiscal and economic reforms, led most notably by Saudi Arabia.

While non-oil growth is recovering in some countries, medium-term prospects are likely to remain relatively subdued unless oil prices increase substantially, and remain elevated for a longer period. Nevertheless, the GCC governments will continue to focus on accelerating reform efforts towards economic diversification and private sector development.

Stronger global conditions will support improving trends in GCC trade and investment flows; while fiscal consolidation will continue to benefit as long as oil prices stabilise around current levels. Non-oil revenue diversification measures are likely to scale up gradually, and eventually provide some measure of insulation to regional economies from the vagaries of the oil market.

For regional banks, 2018 will be a pivotal year, highlighted by the need to speed up their transformation into more strategically-focused, technology-driven and operationally-agile institutions; while developing and implementing innovative strategies for sustainable growth.

As our achievements in 2017 illustrate, we are continuing to transform GIB across multiple fronts. Key initiatives include introducing new products and services; enhancing customer service and satisfaction; and strengthening our institutional capability. These are underpinned by a new corporate mindset and related behaviours through which to support the realisation of the Bank's ambitious growth targets. In this respect, we are making good progress in the establishment of a new subsidiary in Saudi Arabia, and the introduction of retail banking in Bahrain, through which to pursue our pan-GCC strategic ambitions.

Looking ahead, while we recognise that 2018 will be another volatile and testing year for the GCC banking sector, we are confident of the Bank's ability to address all future challenges in a proactive and professional manner. As such, we remain optimistic about the prospects for GIB in the future.

Abdulaziz Al-Helaissi
Group CEO and Board Member

Management review (continued)

KEY REGIONAL TRANSACTIONS

Corporate banking

- Mandated lead arranger, financier and hedging counterparty for 12-year US$666 million Shariah-compliant Ijara facility to part finance the acquisition of 18 A320 aircraft by International Airfinance Corporation for leasing to Saudi Arabian Airlines (Saudia).
- Sole provider of contract financing facilities to Shapoorji Pallonji Mideast for the construction of a new office building and international information center awarded by Saudi Basic Industries Corporation (SABIC).
- Financial advisor, mandated lead arranger, financier and facility agent for 8-year US$515 million syndicated financing for a gas processing plant of Bahrain National Gas Expansion Company.
- Mandated lead arranger for 5-year SAR 7,500 million Shariah-compliant revolving credit facility for Saudi Arabian Mining Company (Ma'aden).

GIB Capital

- Lead financial advisor on the privatisation of four airports under a mandate from the Saudi Arabian General Authority of Civil Aviation.
- Joint lead manager and joint bookrunner for US$12.5 billion multi-tranche bond issuance by the Kingdom of Saudi Arabia, which is the third largest sovereign issue to date, and the largest emerging markets bond transaction in 2017.
- Joint lead manager and joint bookrunner for US$3.0 billion multi-tranche bond issuance by the Kingdom of Bahrain, representing the country's largest syndicated capital debt capital market transaction to date, drawing in excess of US$15 billion in demand.
- Joint lead manager and joint bookrunner for US$2.0 billion Sukuk issuance by the Sultanate of Oman, which is the nation's first ever international Sukuk issuance.
- Joint lead manager and joint bookrunner for two US$1.25 billion Sukuk issuances by the Islamic Development Bank.
- Joint lead manager and joint bookrunner for inaugural SAR 11.25 billion local currency Sukuk issuance by Saudi Aramco.

KEY INDUSTRY RECOGNITION

Awards

GIB's business achievements were recognised by the receipt of several prestigious industry awards during 2017. These confirm the Bank's enduring strength, stability and reputation in the face of a highly competitive and rapidly-changing financial landscape.

- GIB was named Safest Bank in Bahrain for the fourth year in a row at the *Global Finance Awards*.
- GIB Capital won four *EMEA Finance Middle East Awards* for the second consecutive year: Best Investment Bank in the Middle East, Best Local Investment Bank in Saudi Arabia and Bahrain, and Best Foreign Investment Bank in Oman.
- In the *Bonds, Loans and Sukuk Deals of the Year,* GIB Capital won two awards:
  - Local Currency Sukuk Deal of the Year for SAR 11.25 billion inaugural Sukuk issuance by Saudi Aramco.
  - Syndicated Loan Deal of the Year for US$822 million conventional credit facility and US$618 million Ijara facility for Aluminium Bahrain.

Rankings

GIB Capital was ranked among the top 10 industry players across all major regional tables:

1st Saudi Riyal Domestic Currency (for the second year)

6th MENA Governments and Agencies (leading regional bookrunner)

6th GCC Bonds and Sukuks

6th MENA Corporates

7th MENA Bonds and Sukuks

10th GCC Sukuk

Corporate social responsibility review

GIB fulfils its responsibilities as a concerned corporate citizen through its corporate social responsibility programme – WAGIB (which means duty). Through activities coordinated by the Bank's Corporate Communications team and Social Committee, WAGIB emphasises themes with long-term positive results in the fields of youth and career development, women's empowerment, community well-being, health awareness and environmental protection.

YOUTH AND CAREER DEVELOPMENT

Young Professional Development Programme 2016 Graduation Ceremony, Bahrain
On 20th April, a graduation ceremony was held for the GIB Young Professional Development Programme Class of 2016, with 29 graduates receiving their certificates from Group Chief Executive Officer Abdulaziz Al-Helaissi and Group Chief Human Resources Officer Helen Lloyd. Over 150 guests attended the awards ceremony at the Diplomat Radisson Blu hotel in Bahrain, followed by lunch and a networking session. Initiated in 2013, this two-year programme provides selected fresh graduates with theoretical and on-the-job training, plus rotation within relevant departments, prior to their placement with the Group.

2nd Annual American Chamber of Commerce Golf Tournament, Bahrain
GIB was a Platinum Sponsor of the 2nd American Chamber of Commerce (AMCHAM) Golf Tournament, which was held on 14th April at the Royal Golf Club in Bahrain. This fund-raising event supports the AmCham Bahrain Internship Programme, which aims to empower recent university graduates to develop their professional skills, and foster key networks to advance their career paths.

Corporate social responsibility review (continued)

CHARITABLE ENDEAVOURS / COMMUNITY WELL-BEING / ENVIRONMENTAL PROTECTION

World Earth Day, Bahrain
GIB organised a tree planting initiative on Saturday 22nd April to observe World Earth Day. Over 100 people, comprising Bank staff and the general public, participated in the event at the Sitra Al Kubra Garden, by planting more than 200 flowers and plants, and 10 palm trees. GIB registered the event on the global campaign site – www.earthday.org – to mark its participation. World Earth Day has an ambitious target of planting 8 billion trees globally by 2020.

Against the Clock Charity Event, Bahrain
A GIB Team took part in the Against the Clock (ATC) charity event and competition, hosted by the Rotaract Club of Bahrain on 21st April at Al Bandar Resort. This annual event is dedicated to raising funds to provide support for children with cancer, and to refurbish the Pediatric Oncology Department at Salmaniya Medical Centre. ATC is a competition that involves athletics, team work, effective communication and leadership skills. Each team, composed of 8 participants, completes a series of challenging land and water games as quickly as possible.

GIB Riyadh Marathon, Saudi Arabia
On 24th February, GIB continued its sponsorship of the Riyadh Marathon, which is organised by the Riyadh Road Runners. Eight GIB employees took part in the race that attracted over 200 participants. Funds raised from the sponsors' donations and runners' participation fees were used to support the Mawaddah charity, which helps children of divorced parents, and aims to minimise the effects of divorce in Saudi Arabia. The charity is currently building a home where children of divorcees can meet.

37th Bahrain Marathon Relay
GIB fielded a team in the 37th Bahrain Marathon Relay, which was held at Bahrain International Circuit on 24th November. GIB is a long-standing supporter of this race, which is one of the Kingdom's most popular and enduring charitable fund-raising events, organised annually by the Bahrain Round Table in association with the Bahrain Athletics Association.

WOMEN'S EMPOWERMENT

Women in Technology Training Programme, Saudi Arabia
On 25th September, GIB launched the 'Women in Technology' training programme for Saudi women in partnership with Effat University. A leading private non-profit higher education institution for women in Saudi Arabia, Effat University operates under the umbrella of King Faisal's Charitable Foundation. GIB representatives Mushari Al Otaibi and Ghada Bokhamseen welcomed the first batch of students. The 10-week programme is designed to empower Saudi women by improving their employment skills through computer literacy and professional development training, which will enable them to begin their careers and pave the way for new training opportunities. The first batch of students graduated on 7th December.

HEALTH AWARENESS

Blood Donation Campaigns, Bahrain and Saudi Arabia
Throughout 2017, GIB organised a series of blood donation campaigns for its employees in Bahrain and Saudi Arabia. These were held in collaboration with King Hamad University Hospital and Salmaniya Medical Centre in Bahrain; and in Saudi Arabia with King Faisal Specialist Hospital & Research Centre in Riyadh, King Abdulaziz University Hospital in Jeddah, and the Saudi Centre for Organ Donation Society in Dhahran. Over 202 staff took part to contribute to the communal blood supply in both kingdoms.

GIB Staff Health Day, Bahrain
GIB organised a health day for its employees in Bahrain on 30th March. A general check-up – including blood pressure and sugar checks, height, weight and BMI, as well as dental and ophthalmology screenings – was organised, with more than 135 staff members taking part. The employees also benefited from nutritional and dermatological advice, alongside tips to stop smoking.

Breast Cancer Awareness, Bahrain and Saudi Arabia
On the occasion of International Breast Cancer Awareness Month in October, GIB hosted staff-engagement and fund-raising activities in Bahrain, Dhahran, Riyadh and Jeddah, in support of Think Pink Bahrain and the Saudi Cancer Foundation. In Bahrain, GIB lit its headquarters building in pink for the whole month, while employees dressed in pink clothes and decorated their offices with pink accessories. The founder of Think Pink Bahrain, Julie Sprakel, presented an easy-to-use i-Check app for breast self-examination to GIB employees, and answered their questions about breast cancer awareness.

World Down Syndrome Day, Bahrain and Saudi Arabia
In recognition of World Down Syndrome Day on 21st March, GIB supported the Bahrain Down Syndrome Society (BDSS) and the Down Syndrome Charitable Association (DSCA) in Riyadh. BDSS organised a public awareness event at Seef Mall Bahrain, which included the distribution of awareness leaflets and an information session, plus games and music. Children from the Centre and their parents, together with BDSS directors and staff, were present at the event.

Events calendar

Throughout 2017, GIB hosted, sponsored and participated in several keynote industry events in the USA, Europe, UAE, Saudi Arabia and Bahrain. Coordinated by the Bank's Corporate Communications team, these events focused primarily on supporting the development of the regional banking sector, while raising awareness of GIBs products and services.

FEBRUARY

Microsoft Transform Conference, Saudi Arabia
GIB Board Member, Dr. Yahya Alyahya, was a speaker at the Microsoft Transform Conference, held on 14th February at the Four Seasons Hotel in Riyadh, and themed 'Accelerating the Pace of Digital Transformation'. Dr. Alyahya spoke about GIB's pioneering digital banking proposition 'meem', how digital transformation is changing banking, and the future of banking in Saudi Arabia.

MARCH

9th Annual IIF G20 Conference, Germany
GIB sponsored the 9th Annual Institute of International Finance (IIF) G20 Conference that took place on 15th and 16th March in Frankfurt. This high-level public-private sector conference brought together senior policymakers and regulators with leading banking and financial services executives.

GIB Bond Issuance Presentation, Bahrain
GIB was invited by the Capital Club Bahrain on 6th March to provide a presentation on the Bank's successful US$500 million long 5-year bond issuance in January. GIB Group Chief Investment & Treasury Officer Steve Moulder, and GIB Capital Head of Debt Capital Markets Rod Gordon, presented an overview of the bond issue process; and provided insight into GIB's expertise in debt capital markets.

MARCH

5th Annual Harvard Business School Crossroads Conference, Dubai
GIB sponsored the 5th Harvard Business School Club of GCC Crossroads Conference that took place at the Four Seasons Hotel in Dubai on 22nd March. Presentations and panel sessions covered topics such as innovation in business, FinTech, automation and robotics.

APRIL

IIF MENA Chief Risk Officer Forum, Bahrain
GIB hosted the International Institute of Finance (IIF) MENA Chief Risk Officer Forum, which was held in Bahrain on 17th April at the Four Seasons Bahrain Bay. GIB Group CEO Abdulaziz Al-Helaissi and senior management attended the forum, while Chief Risk Officer Masood Zafar took part in the Risk Management Trends panel.

MAY

12th Annual Euromoney Saudi Arabia Conference
GIB was lead sponsor of the 12th Annual Euromoney Saudi Arabia Conference, which was held on 2nd and 3rd May in Riyadh, under the theme '2030: Delivering the Vision'. Topics covered Saudi Arabia's economy and fiscal policy; equity and debt capital markets; real estate industry and Real Estate Investment Trust (REIT); and the impact of FinTech on the banking sector. GIB Group CEO Abdulaziz Al-Helaissi participated in the CEO Roundtable.

9th Annual Compliance and AML Seminar, Saudi Arabia
GIB sponsored the 9th Annual Compliance and Anti-Money Laundering Seminar, which took place in Riyadh on 15th and 16th May. GIB Group CEO Abdulaziz Al-Helaissi participated in a panel debating FinTech versus traditional banking; while Group Head of Compliance and Group MLRO Yasser Al-Anssari was member of a panel discussing methodologies to combat financial crime.

Events calendar (continued)

MAY

Bonds, Loans & Sukuk Conference, Dubai
GIB was a sponsor of the Bonds, Loans & Sukuk Conference held in Dubai on 17th and 18th May. GIB Capital Head of Debt Capital Markets Rod Gordon took part in a panel themed 'Conducting Business in the New Norm'; while GIB Capital Head of Asset Management Abdulhadi Al Shahada was moderator of a panel themed 'Saudi Arabian Debt Globalisation'

JUNE

Four Seasons Ramadan Tent, Saudi Arabia
GIB was Gold Sponsor of the Four Seasons Riyadh Ramadan tent, which included placement of a booth promoting the Bank's retail 'meem' products, and providing an ATM throughout the Holy Month of Ramadan.

SEPTEMBER

Saudi Arabia National Day Celebrations, Bahrain
GIB sponsored a reception organised and hosted by the Saudi Arabian Embassy in Bahrain on 24th September to celebrate the Kingdom's National Day. The reception was held at the Ritz Carlton Hotel & Spa, and was attended by GIB Group CEO Abdulaziz Al-Helaissi and members of the GIB Management Team.

OCTOBER

IMF / World Bank Meeting, USA
As a member of the Bahrain Association of Banks (BAB), GIB sponsored the annual BAB reception for Bahraini banks at the annual IMF / World Bank Meeting, which took place in Washington during October. A high-profile Bahraini delegation was led by the Minister of Finance, Shaikh Ahmed bin Mohammed Al Khalifa; and the Governor of the Central Bank of Bahrain, Mr. Rasheed Al-Maraj.

NOVEMBER

3rd Annual Finestra Universe Conference, Dubai
GIB Head of Global Transaction Banking (GTB), Gurumurthy Palani, was a speaker at the 3rd Annual Finestra Universe Conference held on 8th November in Dubai. Guru took part in a panel entitled 'Unfolding Digital Innovation in Trade Finance', covering operations optimisation, digital innovation across purchase order and invoice-based financing, and Blockchain versus distributed ledger technology.

5th Annual Trade Finance Summit

5th Annual Trade Finance Summit, Saudi Arabia
GIB sponsored the 5th Saudi Trade Finance Summit which took place in Al Khobar on 14th and 15th November. GIB Head of Global Transaction Banking, Gurumurthy Palani, conducted a presentation on 'Key Enablers for Saudi 2030 Vision in the Context of Supply Chain Finance'; while Hariraj Subramanian, Head of Cash Management Products, was member of a panel entitled 'Optimising Cash Flow'.

NOVEMBER

2nd Annual GIB Golf Cup, Saudi Arabia
The 2nd Annual GIB Golf Cup was held at the Dirab Country & Golf Club in Riyadh on 24th November. This invitation-only tournament witnessed the Bank's key clients and business partners playing alongside Group CEO Abdulaziz Al-Helaissi and members of GIB management team. The GIB Golf Cup is now part of Saudi Arabia's golfing calendar and helps GIB to foster stronger relationships with the local business community. Maclaren and Cadillac were this year's sponsors of the hole-in-one prizes.

1st Retail Banking Technologies MENA Summit, Dubai
GIB Group Chief Information Officer Stephen Whitaker chaired the 1st Retail Banking Technologies MENA Summit that was held on 28th and 29th November in Dubai. He also took part in a panel entitled 'Disruptive Technologies in Retail Banking' discussing disruption as a boardroom strategy, the reality of disruption in payments, and the role and importance of Blockchain.

DECEMBER

ICAEW Honours Ceremony, Dubai
GIB sponsored the Middle East Annual Honours Ceremony of the Institute of Chartered Accountants of England and Wales, which was held on 6th December in Dubai. This annual event is dedicated to recognising and rewarding the best accounting and finance talent from across the region.

2nd Annual GIB Golf Cup


meem
Welcome to
Digital Banking
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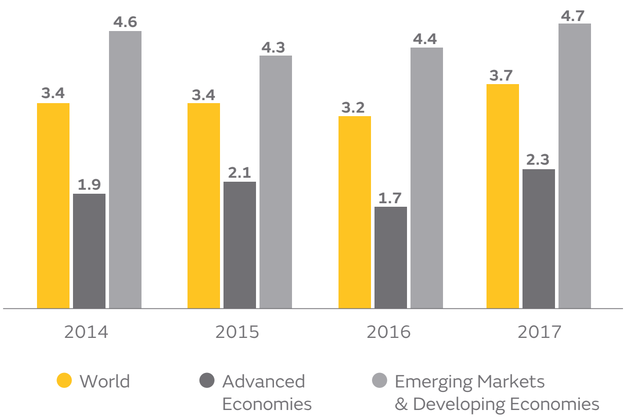
بنك الخليج الدولي
www.meem.com

Economic review 2017

GLOBAL DEVELOPMENTS

Real GDP Growth (%)



Data Source: International Monetary Fund

Key Trends 2017

- Global trends have improved considerably, with growth levels expanding at the fastest rate since 2010. Although the pace of recovery underway is uneven and modest, the strengthening of economic activity has been notable across the advanced economies including the United States and Japan, while growth has stabilised in China and in the emerging markets space.
- The receding of deflation fears during the year, alongside central banks beginning to slowly indicate plans to reduce monetary stimulus, are signs that some semblance of normalcy is on the horizon, albeit overall inflationary pressures still remaining largely muted.
- In the United States, the Federal Reserve modestly raised short-term interest rates three times during the course of the year. Expectations of monetary tightening picking up pace heightened towards the last quarter. On the other hand, the prevalence of negative rates in Europe and Japan underscored the continuation of an accommodative policy stance; while in United Kingdom, continued uncertainty related to Brexit has fuelled anxiety over future prospects.
- In the emerging markets and developing economies, growth prospects have improved primarily supported by a stabilisation of trends in China as well buoyant external demand, notably in the latter half of the year. Despite monetary tightening in the United States, the impact on the region has been negligible, primarily due to the minor rate rises; still abundant global fiscal stimulus; and the overall yield attractiveness of the emerging markets space.
- Energy markets have strengthened during the course of the year, as continued commitment to the OPEC and Non-OPEC agreement to reduce production has started easing the supply glut and improved global economic prospects, which have supported demand dynamics. Oil prices rose above the US$60 a barrel mark in the latter half of the year, albeit exhibiting considerable volatility including challenges from the continued growth in US shale drilling rigs and the intermittent dollar strength.
- On the monetary policy front, the tightening of short-term interest rates in the United States during 2017 marked the start of a diverging trend in global interest rates, with most other advanced economies unlikely to follow the pace of increases. In emerging market economies, financial conditions have remained generally supportive of economic activity with differing monetary policies trends, influenced by domestic conditions rather than US rates.
- Currency and foreign exchange markets remained volatile influenced by tighter monetary policy, US tax-cut prospects and revival in European growth. The US dollar weakened to multi-year lows against currencies of both advanced economies and emerging markets. In spite of expectations of weakening, the pound sterling also ended the year higher, as a number of powerful crosscurrents offset one another. Disappointing economic fundamentals were offset by higher inflation, which fuelled the Bank of England's increasingly hawkish stance. Political developments also added to mix with Prime Minister Theresa May's snap election resulting in a hung parliament.

Economic review 2017 (continued)

GLOBAL TRENDS & OUTLOOK

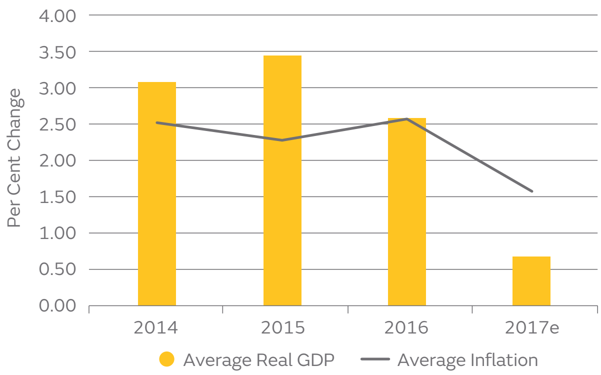
- Global economic activity is expected to continue firming. In its latest forecasts, the International Monetary Fund (IMF) estimates that global growth expanded by 3.7 per cent in 2017 (0.1 percentage point faster than its October 2017 projection), while expectations for 2018 and 2019 are also revised upward by 0.2 percentage point to 3.9 per cent. The IMF cited increased global growth momentum and the positive impact from the recently approved US tax policy changes as key factors supporting the expansion.
- The recent upturn in global crude oil prices has supported headline inflation in advanced economies, and expectations are that this trend will be maintained in spite of wage and core-price inflation likely to continue remaining weak. Among emerging market economies, although inflation has picked up slightly, overall price pressures have been contained by improved monetary policy frameworks. This in turn provides scope for using monetary policy to support demand should activity weaken.
- Despite the improving prospects, the global economy faces a number of uncertainties:
  - Expectations of political stress did not pan out in 2017 despite the continued Brexit uncertainty and the election of Donald Trump. However, 2018 is expected to deliver more meaningful political shocks fuelled by vulnerability of inflated asset prices; Brexit talks on the way to March 2019; tough elections in countries like Italy; and potential of US economic, trade and foreign policies to have international ramifications.
  - There is growing evidence that 2017's benign financial environment, supported by exceptionally accommodative policy and generous quantitative easing (QE), is coming to an end. The risk of volatility has ratcheted up, with expectations of intermittent reversals of asset prices on economic and political surprises.
  - Amid economic and inflation growth differentials, monetary policy divergence is likely to become more prevalent, fuelling bouts of uncertainty and volatility across the global financial markets.
  - Favourable global trends will continue to support the emerging and developing markets, which have so far demonstrated resilience to tightening US monetary policy. However, it remains to be seen if this resilience will endure, and the focus shifts to domestic drivers.
  - The link between productivity, output gaps, inflation and interest rates implies a heightened risk of policy mistakes by central banks in an era that has so far been characterised by weakness in productivity, wage growth and inflation.
  - Improved growth prospects have been accompanied by an upturn in the global housing market, with prices appreciating significantly since 2010. In the event of policy missteps or a hawkish pace of monetary tightening, the resultant increase in borrowing costs heightens the risk of a correction.
  - Trade and investment-protectionism risks will rise to the forefront, and are expected to toughen global trade practices and lead to disruptive practices by sovereigns.

GCC TRENDS & OUTLOOK

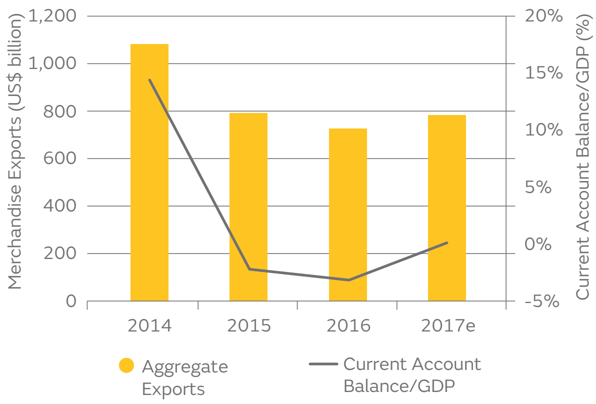
- Oil prices have doubled over the past two years and are expected to remain above US$60 a barrel. GCC growth prospects have improved as a result, with the IMF forecasts upgrading real GDP to average 2.9 per cent in 2018, following an estimated 0.7 per cent expansion in 2017.
- The upward trajectory in oil prices has been supported by the OPEC/Non-OPEC agreement and firming global demand. However, overall price trends will remain volatile, influenced by developments in the US shale space. This new dynamic is urging GCC countries to embrace structural reform and diversify the economy's reliance on oil revenues through public sector spending and energy subsidies. GCC countries have outlined various reform plans and diversification strategies, along with private sector development, in a bid to boost non-oil growth in the medium term.
- Despite the deterioration in economic fundamentals, sentiment towards the GCC economies has improved recently as regional governments pursue structural and fiscal reforms, privatise public assets, improve economic efficiency, and reduce subsidies; while expanding the role of the private sector with the aim to encourage private investment and job creation.
- Several fiscal consolidation measures including reduction in recurrent spending; cuts in capital expenditures; energy price reforms; and the introduction of non-oil revenue generating measures such as value added tax (VAT) and excise duties; have contributed in strengthening state finances. Additional measures are on the horizon, with the overall aim to strengthen medium-term fiscal position.
- The ongoing adjustment process is being supported by still low public debt levels and substantial financial buffers. Recently, GCC sovereign borrowing has risen sharply in an effort to tap external funding to finance deficits and support the economic reform process. However, as fiscal consolidation efforts continue and oil prices can be sustained around current levels, this will likely reduce the need to borrow.
- Regional capital market activity has increased amid the surge in GCC debt issuances, which has included a combination of conventional bonds and Islamic Sukuk issuances. This is supporting the further development of GCC capital markets including building the yield curve and setting benchmarks.
- GCC banks have demonstrated resilience in spite of the oil price decline and intermittent episodes of tightening liquidity conditions. The recent stabilisation in oil prices and narrowing fiscal deficits have improved the operating environment for regional banks, and provide further support to robust earnings and strong capital adequacy ratios. Although problem loans have edged higher due to the slowing economic conditions, these still remain at low levels.
- Although oil prices have risen significantly and global growth prospects have improved (thereby firming oil demand), the GCC economic environment will remain challenging as reform and restructuring policies are pursued against the backdrop of strong economic and financial linkages to oil price movements. Geopolitical risks will also test the region's resilience in this time of unprecedented change.

GCC DEVELOPMENTS

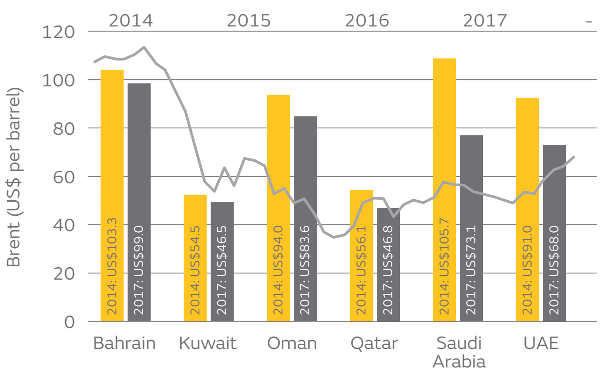
Real GDP & Inflation



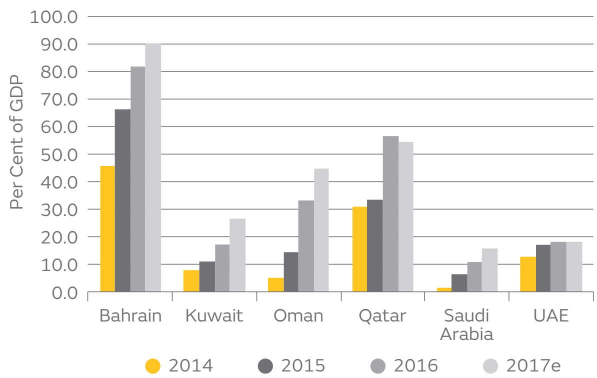
Merchandise Exports & Current Account Balance



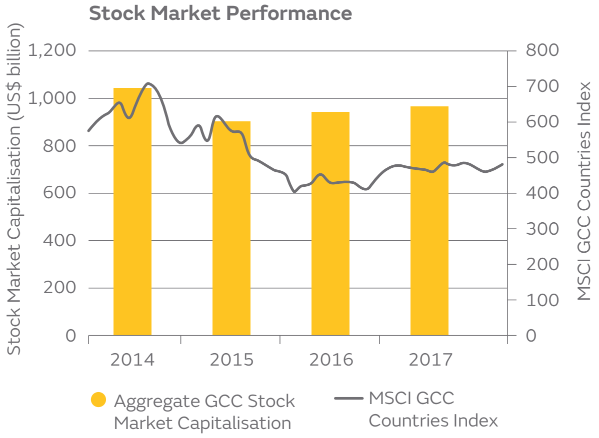
Fiscal Breakeven Oil Prices & Crude Oil Prices



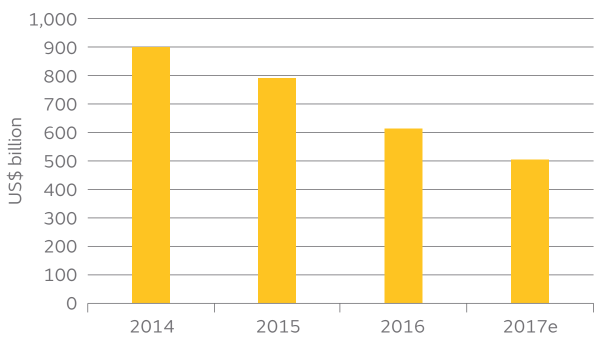
General Government Gross Debt



Stock Market Performance



Foreign Exchange Reserves



Data Source: International Monetary Fund and Bloomberg

Financial review

GIB recorded consolidated net income after tax of US$70.0 million for the year ended 31st December 2017, compared to US$37.3 million in the prior year. Total income at US$360.3 million was US$60.3 million or 20 per cent higher than in 2016, with increases in net interest income, fee and commission income, and trading income being marginally offset by a decrease in other income.

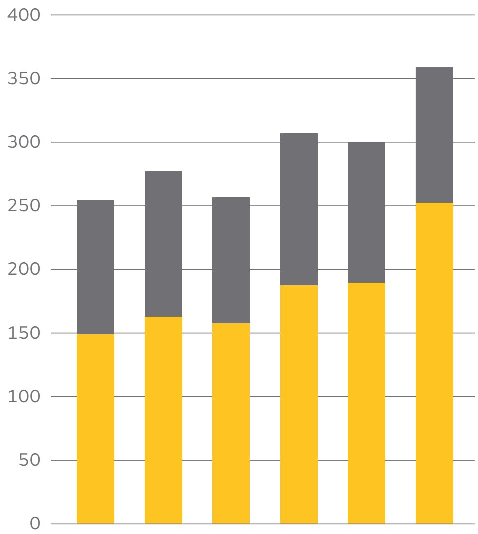
Other income in 2016 included an exceptional asset recovery of US$8.5 million arising on the sale of a previously written off asset. The US$60.3 million year-on-year growth in total income was three times the increase in total expenses of US$21.0 million, largely associated with GIB's new innovative digital retail banking proposition, resulting in a 49 per cent improvement in net income before provisions and tax.

Net interest income, which at US$253.1 million represented the Bank's largest income source, was US$63.1 million or 33 per cent up on the prior year. This reflected increases in all sources of interest income, although in particular increases in both loan volumes and loan margins, as the Bank continues to successfully re-orientate its lending activities from transactional-based long-term project and structured finance to relationship-based corporates. Additionally, as explained in more detail in the net interest income section of the Financial Review, these increases were accompanied by a decrease in the Group's wholesale deposit premium expense in 2017. Liquidity constraints in the region that prevailed during most of 2016, subsided in 2017.

Fee and commission income at US$72.6 million was US$6.4 million or 10 per cent up on 2016, and comprised 20 per cent of total income. This underlined the success of GIB's strategic focus on relationship-orientated products and services, and the enhancement of fee income. Foreign exchange income at US$14.1 million was marginally lower than the prior year, and primarily comprised revenue from customer-related activities, and in particular, revenues derived from bespoke structured products designed to assist customers in hedging their foreign exchange exposures in volatile markets. Trading income at US$13.0 million was US$1.1 million up on the prior year level. Trading income principally comprised customer-related interest rate derivative income and gains on investments in funds managed by both the Group's London-based subsidiary, GIB (UK) Limited, and its Saudi Arabia-based subsidiary, GIB Capital C.J.S.C. Other income at US$7.5 million was US$10.0 million lower than in 2016 mainly due to an exceptional asset recovery of US$8.5 million in 2016 arising on the sale of a previously written off asset.

Total expenses at US$240.0 million for the year were US$21.0 million or 10 per cent up on 2016. The increase was attributable to the ongoing investment in GIB's new digital retail banking proposition. A loan provision charge of US$43.7 million in 2017 compared to a US$38.6 million charge in 2016, reflecting the Group's conservative provisioning approach in view of prevailing market conditions.

Gross income development (US$ millions)



	2012	2013	2014	2015	2016	**2017**
Non interest income	105.6	115.2	99.6	119.8	110.0	**107.2**
Net interest income	149.4	163.1	158.0	188.2	190.0	**253.1**
Gross income	255.0	278.3	257.6	308.0	300.0	**360.3**

NET INTEREST INCOME

Net interest income at US$253.1 million was US$63.1 million higher than in the prior year.

Net interest income is principally derived from the following sources:-

- margin income on the wholesale loan portfolio,
- earnings on the investment of the Group's net free capital,
- money book activities, and
- margin income on the investment securities portfolio.

Net interest income is also net of the cost of term finance, cost of liquidity, and premiums over the benchmark interest rates for wholesale deposits.

Higher interest earnings were derived from all sources of interest income, i.e. the wholesale loan portfolio, the investment securities portfolio, the money book, and the investment of the net free capital. Additionally, these underlying positive trends in interest earnings were accompanied by a decrease in the wholesale deposit premium expense in 2017. Liquidity constraints prevailing in the region during the first nine months of 2016 subsided in the fourth quarter and the premiums over the benchmark interest rates have reverted to normalised levels in 2017.

Interest earnings on the wholesale loan portfolio accounted for 68 per cent of the Group's net interest income, before the cost of term finance and wholesale deposit premium expense. Margin income derived from wholesale lending was US$24.5 million or 12 per cent higher than the prior year due to higher average performing loan volumes and an increase in average performing loan margins. The average performing loan volume during 2017 was 5 per cent higher than in 2016 and average performing loan margins were 14 basis points higher than the prior year. The increase in both average performing loan volumes and loan margins reflected the ongoing success that has been achieved in the transformation of the Bank's wholesale banking strategy to focus on relationship-based lending.

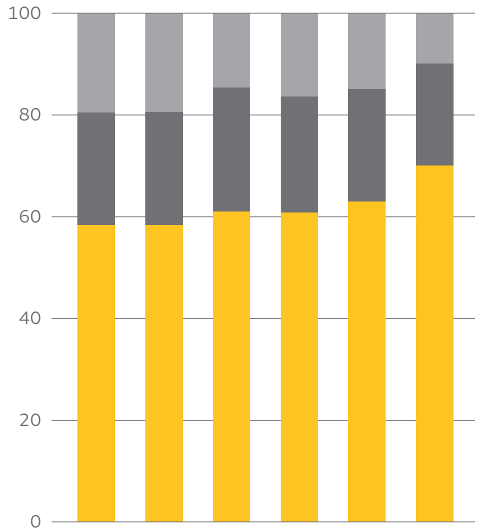
Margin income on the investment securities portfolio accounted for 8 per cent of net interest income, before the cost of term finance and wholesale deposit premium expense. The interest earnings from the investment securities portfolio were 16 per cent higher than in the prior year, reflecting an 11 per cent year-on-year increase in average investment security volumes. The investment securities portfolio is primarily maintained as a liquidity reserve. The key factors underpinning the portfolio are therefore liquidity and quality rather than income-generating characteristics.

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 Group. This includes benefits derived from the mismatch in the repricing profile of the Group's interest-bearing assets and liabilities. Money book earnings in 2017 accounted for 14 per cent of net interest income, before the cost of term finance and wholesale deposit premium expense, and were 13 per cent up on the prior year.

Earnings on the investment of the Group's net free capital, which accounted for 10 per cent of net interest income, before the cost of term finance and wholesale deposit premium expense, were 22 per cent up on the prior year. The net free capital was largely invested in shorter duration government bonds reflecting the Group's view that economic conditions in the United States were more conducive to a rise in US interest rates in the short term, with the shorter tenor fixed rate instruments providing the opportunity to reinvest on maturity at higher yields as interest rates rise in the short- to medium-term.

Financial review (continued)

Gross income composition (%)



	2012	2013	2014	2015	2016	**2017**
Foreign exchange, trading & other income	19.2	19.1	14.3	16.1	14.6	**9.6**
Fee & commission income	22.2	22.3	24.4	22.8	22.1	**20.1**
Net interest income	58.6	58.6	61.3	61.1	63.3	**70.3**
	100.0	100.0	100.0	100.0	100.0	**100.0**

At the end of 2017, more than half of the Group's net free capital was invested in shorter duration fixed rate instruments, generating an enhanced return over short-term interest rates. A rise in US interest rates would have a direct beneficial impact on the Group's interest earnings.

The cost of term finance increased in 2017 as a result of new term finance facilities that were raised in 2017. In particular, in January 2017, the Bank issued a US$500 million five-year bond which was more than two times oversubscribed. The Bank has also raised term deposits through a number of alternatively-priced placements. The Group continues to minimise its previous reliance on funding longer tenor assets with short-term deposits, and the associated liquidity and refinancing risk, with proactive actions having been taken over the previous five years to raise new term finance to minimise this undue risk. As a result, at 31st December 2017, the volume of illiquid assets or assets maturing beyond one year that were funded by non-sticky or short-term deposits represented less than 1 per cent of non-sticky customer deposits. Almost the entirety of customer deposits and all bank deposits therefore funded shorter tenor or liquid assets. This effectively addresses one of the key focuses of the new Basel 3 regulatory guidelines whereby banks will have less ability to fund longer tenor assets with shorter tenor wholesale deposits. The initiatives to reduce the Group's exposure to liquidity risk resulted in a US$41.4 million or 14 per cent reduction in the Group's net interest income in 2017.

The cost of wholesale deposit premiums decreased in 2017, following the liquidity constraints that prevailed during the first nine months of 2016, which lessened as a result of actions taken by central banks in the region to alleviate pressures on the availability of liquidity. As a result, premiums over benchmark interest rates reduced to normalised levels during 2017.

NON-INTEREST INCOME

Non-interest income comprises fee and commission income, foreign exchange income, trading income, and other income.

Fee and commission income at US$72.6 million was US$6.4 million or 10 per cent up on the prior year level. An analysis of fee and commission income with prior year comparatives is set out in note 21 to the consolidated financial statements. Investment banking and management fees at US$34.4 million were the largest source of fee-based income, comprising 47 per cent of fee and commission income for the year, while commissions on letters of credit and guarantee at US$33.6 million represented 46 per cent.

Investment banking and management fees comprise fees generated by the Group's asset management, fund management, corporate advisory, debt and equity capital markets, and underwriting activities. Investment banking and management fees were US$4.6 million or 15 per cent higher than the prior year level, of which asset and fund management fees represented US$3.6 million of the increase on the prior year level. As referred to in note 34 to the consolidated financial statements, assets held in a fiduciary capacity amounted to US$16.0 billion at 31st December 2017 compared to US$13.0 billion at the end of 2016. A US$2.4 million year-on-year increase in commissions on letters of credit and guarantee further contributed to the year-on-year increase in fee and commission income.

Foreign exchange income at US$14.1 million for the year was only US$0.3 million lower than the prior year. Foreign exchange income principally comprised income generated from customer-initiated foreign exchange transactions that were offset in the market with matching transactions. Accordingly, there is no market risk associated with the transactions that contribute to this material source of income. The strong foreign exchange earnings reflected the continued success in the cross-selling of innovative products to meet customers' needs and requirements, and the development of new products to meet those needs. A growing demand is being witnessed for these products as customers experience the benefits derived in effectively managing and hedging their currency exposures. During 2017, the Group continued to expand its customer base to create a broader and a more desirable diversification of earnings from these products, as well as generating repeat business from existing clients.

Key profitability drivers

Driver		2017		2018 and beyond
Loan volume	↑	Increase in average loan volume	↑	Planned increase in 2018 and beyond to target level of $ 11 billion
Loan margins	↑	Increase in core loan portfolio margins through successful strategic re-orientation of lending activities	↑	Continued increase in loan margins through strategic re-orientation of lending activities
Income on net free capital	↑	Increase in interest yield due to rising US$ interest yields	↑	Benefit from rising interest rate environment
Treasury money book	↑	Effective management of interest repricing mismatch profile	↑	Ongoing increase in asset and liability volumes
Term finance cost: liquidity risk cost	↑	New facilities raised in 2017, largely from a US$500 million five-year bond in January that was more than two times oversubscribed	↓	Term finance to be replaced by retail and transaction banking deposits in the medium- to long-term
Fee and commission income	↑	Higher trade finance-related income, asset and fund management fees and corporate advisory fees	↑	Focus on cross selling of fee-based products and services
Treasury customer-related income: foreign exchange and interest rate derivatives	↓	Lower income from interest rate derivatives in 2017 due to exceptional one-off profits in 2016	↑	Focus on cross selling of treasury products and development of new products
Operating expenses	↑	Higher retail banking marketing expenses and an increase in the depreciation and maintenance of information technology assets	↔	Stabilisation of expenses
Loan provisions	↑	Marginally higher loan provision charges	↔	Specific provisioning requirements to be reallocated from non-specific provisions

↑ ↓ Higher Profitability ↑ ↓ Lower Profitability ↔ Unchanged Profitability

The Group's various trading activities recorded a US$13.0 million profit for the year compared to a US$11.9 million profit in the prior year. Trading income is reported inclusive of all related income, including interest income, gains and losses arising on the purchase and sale, and from changes in the fair value of trading securities, dividend income, and interest expense, and including all related funding costs. An analysis of trading income is set out in note 23 to the consolidated financial statements. Trading income in 2017 principally comprised profits recorded on customer-related interest rate derivative income and managed funds. A US$6.6 million profit was generated from customer-related interest rate derivatives, representing 51 per cent of trading income in 2017. During 2016 and 2017, the interest rate derivative product range was expanded, with a greater focus on working constructively with customers to identify opportunities to hedge their interest rate exposures, particularly in the context of expectations of a rising interest rate environment.

Profits from managed funds of US$6.0 million in 2017 were US$3.9 million up on the 2016 level. This increase was largely attributable to seed investments in new funds managed by the Group.

Other income of US$7.5 million was recorded for the year. An analysis of other income is set out in note 24 to the consolidated financial statements. Other income principally comprised US$6.9 million of dividends received from equity investments classified as fair value through other comprehensive income (FVTOCI), and US$1.8 million of recoveries of assets previously written off. A US$7.0 million year-on-year decrease in asset recoveries was mainly due to an exceptional asset recovery of US$8.5 million in 2016 arising on the sale of a previously written off asset.

Financial review (continued)

OPERATING EXPENSES

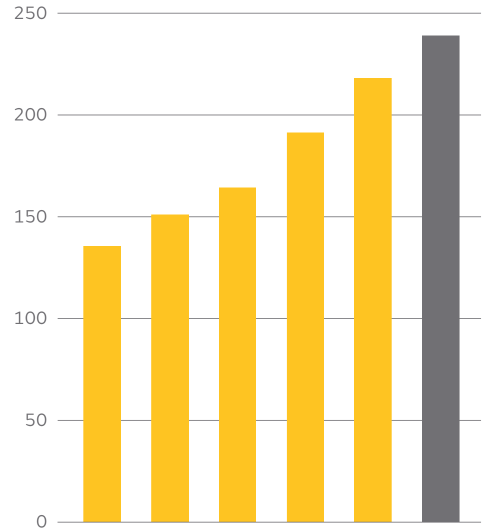
Operating expenses at US$240.0 million were US$21.0 million or 10 per cent up on the prior year. The year-on-year increase was principally attributable to costs associated with the implementation of the Group's new universal banking strategy, in particular the new digital retail banking proposition, and the depreciation and maintenance of information technology assets.

Staff expenses, which at US$142.6 million accounted for almost 60 per cent of total operating expenses, were US$5.7 million or 4 per cent up on the prior year. The year-on-year increase was largely attributable to a US$4.0 million release of an unutilised prior year bonus reserve in 2016. Excluding this exceptional item in 2016, staff expenses were up by only 1 per cent. The Group's total headcount of 1,127 at 31st December 2017 was 16 higher than at the end of 2016. The headcount at 31st December 2017 included 144 retail banking front office staff.

Premises expenses at US$19.6 million were only US$1.5 million or 8 per cent up on the prior year. This was largely due to the write off of the remaining costs relating to the old Abu Dhabi branch and decommissioned Retail nano stores that are being replaced by state-of-the-art self-service stores in key shopping malls across the Kingdom of Saudi Arabia.

Other operating expenses at US$77.8 million were US$13.8 million higher than the prior year. The year-on-year increase was principally due to a higher IT depreciation expense in 2017, higher marketing expenses relating to the new retail banking proposition and exceptional expenses incurred in 2017 in relation to the planned KSA subsidiary. The increase in IT depreciation was partly attributable to a backdated adjustment in 2016 relating to an increase in the estimated useful life of depreciated items.

Expenses development (US$ millions)



	2012	2013	2014	2015	2016	**2017**
Operating expenses	136.1	151.6	164.9	192.1	219.0	**240.0**

PROVISIONS

In 2017, there was a conservative US$43.7 million net loan provision charge. The charge comprised the net of a US$52.6 million specific provision charge and an US$8.9 million release of non-specific provisions.

In 2016, the Group early adopted the new expected credit loss impairment methodology for non-specific provisions in accordance with IFRS 9 (2014) Financial Instruments. IFRS 9 (2014) replaces the backward looking incurred loss model in IAS 39 with a forward looking expected credit loss model. Accordingly, under IFRS 9 (2014) credit losses are recognised earlier than under IAS 39. In accordance with the IFRS 9 (2014) expected credit loss methodology, non-specific provisions are based on one year point-in-time probabilities of default (defined as stage 1) unless there has been a significant increase in credit risk whereupon the non-specific provisions are based on the lifetime probability of default (defined as stage 2). IFRS 9 (2014) is mandatory from 1st January 2018, although was early adopted by the Group with effect from 1st January 2016. The total loan specific and non-specific provision charge equated to 41.8 basis points based on gross loans of US$10,456.7 million at 31st December 2017. This is well within the expected credit loss for the loan portfolio based on the rating profile and the prevailing related probabilities of default.

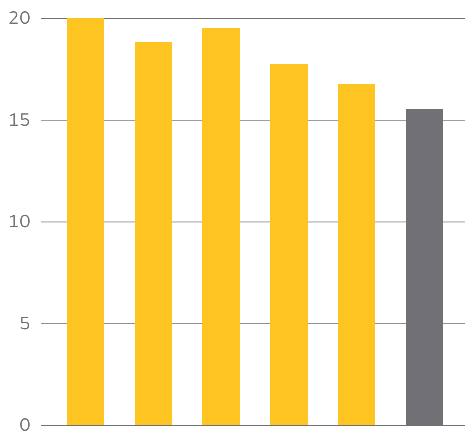
CAPITAL STRENGTH

Total equity amounted to US$2,410.9 million at 31st December 2017. At the 2017 year end, the ratio of equity and tier 1 capital to total assets were both 9.5 per cent, ratios that are relatively high by international comparison.

A US$53.5 million increase in total equity during 2017 mainly comprised the net of the US$70.0 million profit for the year, a US$17.9 million net decrease in the fair value of equity investments classified as FVTOCI, and a US$1.9 million increase arising on the remeasurement of the defined benefit pension fund of the Group's London-based subsidiary, Gulf International Bank (UK) Limited.

With a total regulatory capital base of US$2,563.5 million and total risk-weighted exposure of US$16,410.3 million, the risk asset ratio calculated in accordance with the Central Bank of Bahrain's Basel 3 guidelines was 15.6 per cent while the tier 1 ratio was 14.7 per cent. In accordance with international regulatory guidelines, the fair value adjustments to equity arising under IFRS 9 in relation to derivative cash flow hedges are excluded from the regulatory capital base, while unrealised gains and losses on equity investments classified as FVTOCI are included in the regulatory capital base.

Risk asset ratio (%)



	2012	2013	2014	2015	2016	**2017**
Risk asset ratio	20.1	18.9	19.6	17.8	16.8	**15.6**

At 31st December 2017, the regulatory capital base would support an additional US$1.9 billion of 100 per cent risk-weighted assets, while still maintaining the Group's target minimum risk asset ratio of 14 per cent. The Group therefore has more than sufficient regulatory capital to support future growth plans.

The risk asset ratio incorporates both market and operational risk-weighted exposures. With approval from the Central Bank of Bahrain, the Group applies the internal models approach for market risk, and the standardised approach for determining the capital requirement for operational risk. This demonstrates that the Group's regulator is satisfied that the Group's risk management framework fully meets the guidelines and requirements prescribed by both the Central Bank of Bahrain and the Basel Committee for Banking Supervision.

The Central Bank of Bahrain adopted the Basel 3 regulatory capital framework with effect from 1st January 2015. The Basel 3 framework revises the definition of regulatory capital. The application of the Basel 3 regulatory capital framework had only a very limited impact on the Bank's regulatory capital ratios.

The Risk Management and Capital Adequacy report set out in a later section of the Annual Report provides further detail on capital adequacy and the Group's capital management framework. The Group's policies in relation to capital management are set out in note 26.5 to the consolidated financial statements. As described in more detail in the note, the Group's policy is to maintain a strong capital base so as to maintain investor, counterparty and market confidence and to sustain the future development of the Group's business.

ASSET QUALITY

The geographical distribution of risk assets is set out in note 27 to the consolidated financial statements. The credit risk profile of financial assets, based on internal credit ratings, is set out in note 26.1(b) to the consolidated financial statements. This note demonstrates that 78 per cent of all financial assets, comprising liquid assets, placements, securities, loans, and credit-related contingent items, were rated 4- or above, i.e. the equivalent of investment-grade rated.

Further assessment of asset quality can be facilitated by reference to note 36 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 at 31st December 2017 were not significantly different to their carrying amounts.

At the 2017 year end, cash and other liquid assets, reverse repos and placements accounted for 42 per cent of total assets, investment securities accounted for 16 per cent, while loans and advances represented 39 per cent.

Investment Securities

Investment securities totalled US$3,993.8 million at 31st December 2017. The investment securities portfolio primarily represents the Group's liquidity reserve and accordingly, principally comprises investment-grade rated debt securities issued by major international and regional financial institutions and government-related entities.

Investment securities comprise two types of debt security portfolios and a limited investment in equities and equity funds. 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 US$2,645.1 million, or 69 per cent, of total investment debt securities at the 2017 year end. The smaller debt security portfolio represents the investment of the Group's net free capital in fixed rate securities. This portfolio amounted to US$1,178.0 million at the end of 2017 and comprised investments in OECD and GCC government-related bonds.

Equity investments at the end of 2017 amounted to US$170.7 million. Equity investments at 31st December 2017 included listed equities amounting to US$100.8 million received in settlement of a secured past due loan. The remaining equity investments largely comprised private equity-related investments.

Financial review (continued)

An analysis of the investment securities portfolio by rating category is set out in note 9.1 to the consolidated financial statements. US$3,326.7 million or 87 per cent of the debt securities at the 2017 year end were rated A- / A3 or above. Based on the rating of the issuer, a further US$267.1 million or 7 per cent of the debt securities represented other investment-grade rated securities.

The fair value of investment debt securities at 31st December 2017 was US$3,902.7 million. The fair value was accordingly US$79.6 million greater than the amortised cost. The higher fair value compared to the amortised cost of the investment debt securities reflected the high quality and high ratings of the securities.

There were no past due or impaired investment securities at 31st December 2017.

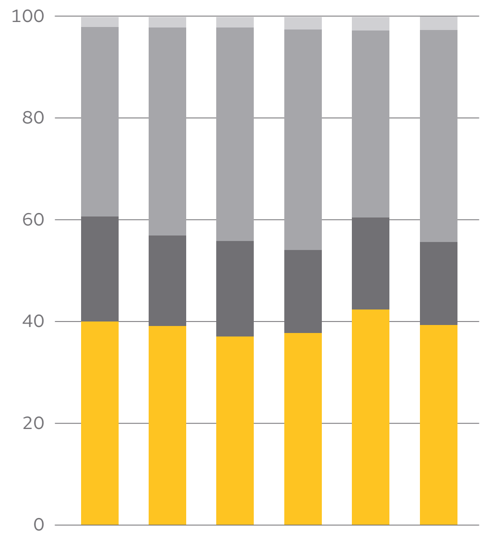
Loans and Advances

Loans and advances amounted to US$10,043.1 million at the 2017 year end. This represented a US$298.0 million or 3 per cent increase compared to the 2016 year end. As is evident from note 39 to the consolidated financial statements, the average volume of loans and advances during 2017 was US$10,310.9 million, being US$697.3 million higher than the average volume during 2016.

Based on contractual maturities at the balance sheet date, 59 per cent of the loan portfolio was due to mature within one year while 79 per cent was due to mature within three years. Only 10 per cent of loans were due to mature beyond five years. Details of the classification of loans and advances by industry are set out in note 10.2 to the consolidated financial statements while the geographical distribution of loans and advances is contained in note 27. At 31st December 2017, 17 per cent of the gross loan portfolio comprised exposure to the energy, oil and petrochemical sector compared to 38 per cent at the end of 2011. This sectorial exposure reflects the Group's previous strategic focus on project finance and syndicated lending in the GCC states. Currently, the largest industry sectorial exposure is to the trading and services sector, comprising 22 per cent of gross loans, reflecting the strategic focus on relationship-based lending. There was limited exposure to the construction and real estate sectors at the 2017 year end.

The credit risk profile of loans and advances, based on internal credit ratings, is set out in note 26.1(b) to the consolidated financial statements. US$5,956.4 million or 59 per cent of total loans were rated 4- or above, i.e. the equivalent of investment grade-rated. Only US$118.8 million of loans and advances, net of provisions for impairment, were classified as stage 3 exposures in accordance with IFRS 9 (2014), i.e. credit-impaired exposures that had experienced a significant increase in credit risk since inception.

Asset mix by category (%)



	2012	2013	2014	2015	2016	**2017**
Other	1.8	1.8	1.8	2.2	2.4	**2.3**
Placements & other liquid assets	37.3	41.0	42.1	43.5	36.9	**41.8**
Securities	20.7	17.9	18.9	16.4	18.2	**16.4**
Loans & advances	40.2	39.3	37.2	37.9	42.5	**39.5**
	100.0	100.0	100.0	100.0	100.0	**100.0**

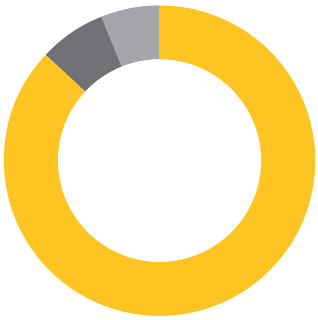
Total loan loss provisions at 31st December 2017 amounted to US$413.6 million. Counterparty specific provisions amounted to US$261.0 million while non-specific provisions were US$152.6 million. Total provisions of US$413.6 million represented 86 per cent of the gross book value of past due loans.

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 loan provisions at 31st December 2017 amounted to US$152.6 million, representing a high 1.5 per cent of non-specifically provisioned loans.

For the purpose of the calculation of the non-specific provision, the Group only takes account of collateral held in the form of cash or exchange-traded equities. While collateral in the form of securities, unlisted equities and physical assets is used for risk mitigation and protection purposes, it is not taken into account in the calculation of the non-specific provision.

Investment debt securities rating profile



	US$ millions	%
AAA to A-/Aaa to A3	3,326.7	87.0
BBB+ to BBB-/Baa1 to Baa3	267.1	7.0
BB+ to BB-/Ba1 to Ba3	229.3	6.0
	3,823.1	**100.0**

Loan maturity profile

	US$ millions	%
Year 1	5,884.1	58.6
Years 2 & 3	2,023.2	20.1
Years 4 & 5	1,124.3	11.2
Over 5 years	1,011.5	10.1
	10,043.1	**100.0**

The gross and net book values of past due loans at 31st December 2017 amounted to US$479.4 million and US$218.8 million respectively. Past due loans at the 2017 year end included some larger sized loan facilities that were in the final stages of restructuring. The restructurings are anticipated to be finalised in the first half of 2018. The specific provisioning coverage for past due loans was 54 per cent. Past due loans are defined as those loans for which either principal or interest is over 90 days past due. Under IFRS 9, 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 Group's regulator, the CBB, 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.

Other Asset Categories

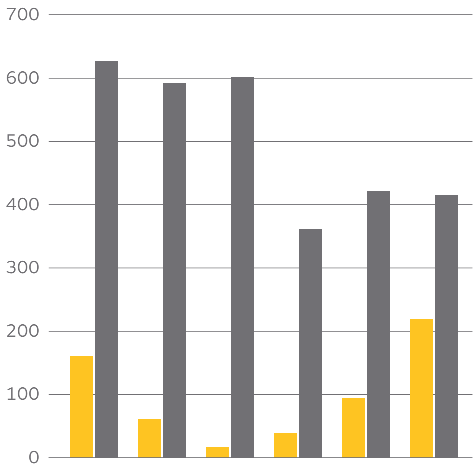
Cash and other liquid assets, amounting to US$3,768.5 million at the 2017 year end, are analysed in note 5 to the consolidated financial statements. They principally comprised cash and balances with central banks and banks in the key geographic locations in which the Group operates.

Placements totalled US$6,033.2 million at the 2017 year end and were well diversified by geography as illustrated in note 27 to the consolidated financial statements. Placements were largely with European, GCC and North American bank counterparties, representing the Group's principal operating locations. Placements represented 24 per cent of total assets at the 2017 year end. The year-on-year increase in placements was principally due to an increase in deposits from customers reflecting a higher level of deposit activity by the Group's London-based subsidiary, Gulf International Bank (UK) Limited. At the end of 2017, placements were supplemented by US$855.0 million of securities purchased under agreements to resell. These represented collateralised placements, thereby reducing the Group's risk exposure to the financial institution sector.

Trading securities at US$191.8 million at 31st December 2017 largely comprised investments in managed funds. The investment in managed funds increased by US$100.0 million in 2017, principally attributable to seed investments in new funds managed by the Group.

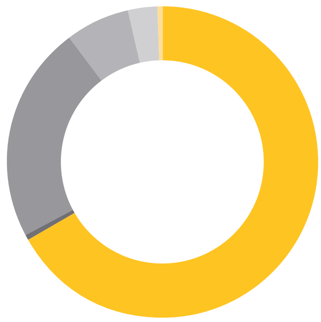
Financial review (continued)

PDO loan development (US$ millions)



	2012	2013	2014	2015	2016	**2017**
Net PDO loans (US$ millions)	159.8	61.4	16.1	38.7	94.0	**218.8**
Provisions (US$ millions)	625.7	591.3	601.1	361.0	421.0	**413.6**

Risk asset and commitment exposure



	US$ millions	**%**
GCC	20,095.7	67.2
Other MENA	29.9	0.1
Europe	6,787.4	22.7
North America	2,017.7	6.7
Asia	962.9	3.2
Latin America	19.7	0.1
	29,913.3	**100.0**

Risk Asset and Commitment Exposure

Risk asset and commitment exposure at 31st December 2017 amounted to US$29,913.3 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 referred to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 27 to the consolidated financial statements. As is evident from this note, US$20,095.7 million or 67 per cent of total risk assets and commitments represented exposure to counterparties and entities located in the GCC states. The remaining risk asset exposure largely represented short-term placements with major European banks, and investment securities issued by highly-rated issuers in Europe, North America and Asia. An analysis of derivative and foreign exchange products is set out in note 30 to the consolidated financial statements while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 31.

Deposits - geographical profile

	US$ millions	**%**
GCC countries	12,600.2	69.5
Other MENA	779.3	4.3
Other countries	4,739.4	26.2
	18,118.9	**100.0**

FUNDING

Bank and customer deposits at 31st December 2017 totalled US$18,118.9 million. Customer deposits amounted to US$15,989.8 million at the 2017 year end, representing 88 per cent of total deposits. Bank deposits at 31st December 2017 amounted to US$2,129.1 million, representing only 12 per cent of total deposits.

Total deposits are analysed by geography in note 13 to the consolidated financial statements. US$12,600.2 million or 70 per cent of total deposits were derived from counterparties in GCC countries. Deposits derived from non-MENA countries, principally Europe, amounted to US$4,739.4 million or 26 per cent of total deposits. The deposits from counterparties in non-MENA countries largely related to deposit activity by Gulf International Bank (UK) Limited. These deposits do not represent a core funding source for the Group. This compares to placements, reverse repos and other liquid assets with non-MENA counterparties of US$7,155.5 million and are placed on a short-term basis in the money market. The Group is therefore a net placer of funds in the international interbank market, and accordingly has no net reliance on the international interbank market.

Securities sold under agreements to repurchase (repos) were US$1,130.5 million at 31st December 2017. The Group utilises its high quality and highly rated investment securities to raise funding on a collateralised basis where effective from a cost and tenor perspective, as well as constantly validating its ability to repo the securities as part of the Group's liquidity contingency plans.

Senior term financing at 31st December 2017 totalled US$3,263.6 million. Term finance and equity represented 136 per cent of loans maturing beyond one year.

Further commentary on liquidity and funding is provided in the Risk Management and Capital Adequacy report.

Corporate governance report

Corporate Governance Statement according to Principles of the Corporate Governance Code of the Kingdom of Bahrain and Corporate Governance Principles of the Central Bank of Bahrain (CBB).

SOUND GOVERNANCE

When Gulf International Bank B.S.C. ("GIB" or the "Bank") was established back in 1975, its Agreement of Establishment and Articles of Association ("AoA"), executed at the time by the GCC Governments that created it, set the foundation of solid governance practices for the Bank. From the start, sound corporate governance has been essential at GIB, both in achieving organisational integrity and efficiency as well as in attaining fairness to all stakeholders.

Over the years, GIB has progressively adopted and implemented standards of corporate governance relevant to publicly-traded financial institutions although it is not a listed company. GIB has regularly published a statement on corporate governance in its annual reports since 2003.

Currently, GIB has in place many measures that are hallmarks of good corporate governance practices, such as comprehensive mandates for the Board of Directors ("Board") and for Directors and for Board Committees; a Code of Conduct (Code on Conduct, Ethics and Avoiding Conflicts of Interest) in both English and Arabic published on the Bank's website and detailed operating policies that anticipated the CBB's new requirements. Subsequently, GIB adopted additional measures that included, amongst other things, an updated Board Charter and updated mandates of the Board Committees; an enhanced Whistle Blowing Policy; a Board Corporate Governance Committee; the establishment of a dedicated Corporate Governance Unit within the Compliance department; and an update of its variable remuneration framework to fully comply with the Sound Remuneration Practices issued by the CBB.

The Board and its respective Committees' mandates are subject to an annual review to ensure that they continue to reflect the current processes, best practices and any new regulatory requirements. The last updates were initiated and approved by the Board in its 6th meeting held on 15th December 2017.

The Board Charter is posted in its entirety on the Bank's website (www.gib.com), and largely reflects the corporate governance requirements contained in the HC (High Level Controls) Module of the CBB Rulebook Volume 1.

The measures adopted by GIB formally entrenched a culture of professional corporate governance in the organisation. They also demonstrated GIB's commitment to financial transparency, fairness and disclosure of financial information that will benefit all users of such information, including regulators, customers, counterparties, rating agencies and other stakeholders.

In March of every year, the Board prepares for its Shareholders' Annual General Meeting ("AGM") a report on GIB's compliance with the CBB rules on corporate governance, which explains any non-compliance. The explanations contained in this year's "Comply or Explain" report are reproduced at the end of this section of the Annual Report.

GIB discloses in the Annual Report additional information required to be disclosed in accordance with Section PD-1.3.8 of the CBB Rulebook Volume 1, and the Board also discloses to the Shareholders the information required to be disclosed to them annually in accordance with Section PD-6.1.1 of the Rulebook.

SHAREHOLDERS

The current shareholding structure of GIB is as follows:

Shareholder	Percentage of shareholding
Public Investment Fund Kingdom of Saudi Arabia	97.226%
Kuwait Investment Authority State of Kuwait	0.730%
Qatar Holding Company State of Qatar	0.730%
Bahrain Mumtalakat Holding Company Kingdom of Bahrain	0.438%
State General Reserve Fund Sultanate of Oman	0.438%
Emirates Investment Authority United Arab Emirates	0.438%

ORGANISATION – RULES AND ROLES

GIB maintains a corporate governance structure that delineates and segregates the functions, roles and responsibilities of the Board and Management, and ensures that the requisite separate attribution of responsibilities between them is maintained:

- There is an effective and appropriately constituted Board responsible for the stewardship of the Bank and the supervision of its business; it receives from Management all information required to properly fulfil its duties and the duties of the committees that assist it; and it delegates to Management the authority and responsibility for managing the day-to-day business of the Bank.
- 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 controls.
- There is a clear division of roles and responsibilities between the Board and Management, and between the Chairman and the Group Chief Executive Officer (Group CEO).
- There are defined and documented mandates and responsibilities (as well as delegated authorities where applicable) for Senior Management.

The Bank's corporate governance structure and organisation chart is set out on page 58 of this Annual Report.

BOARD OF DIRECTORS

Under GIB's AoA, the Board comprises up to 10 members to be appointed or elected every three years. The AoA gives the right to each Shareholder holding 10 per cent of the share capital to appoint one member on the Board. The Shareholders exercising this right also have the right to terminate such appointment and replace the relevant Directors. The appointment of Directors is subject to prior approval from the CBB. In December 2017, Dr. Abdullah Alabdulgader assumed the duties of the Chairman of the Board upon the demise of the late H.E. Jammaz Al-Suhaimi. Also, in December 2017, the Board reconstituted its Committees.

GIB has a written appointment agreement with each Director. This agreement describes the Directors' powers, duties, responsibilities and accountabilities, as well as other matters relating to their appointment, including their term, the time commitment envisaged, their assignment on the Board Committees, their remuneration and expense reimbursement entitlement, and their access to independent professional advice when needed.

At the year end, the Board comprised six Directors of whom five are non-executive Directors, including the Chairman and Vice-Chairman, and one executive Director, who together bring a wide range of skills and experience to the Board. Their biographies are set out on page 52 of this Annual Report.

Corporate governance report (continued)

INDEPENDENCE OF DIRECTORS

The independence or non-independence of the Directors is subject to an annual review by the Board. As at 31st December 2017, one Director of the Bank was classified as non-independent in accordance with the CBB regulations, and the other Directors were classified as independent (see table below).

BOARD RESPONSIBILITIES

The Board is responsible for the overall business performance and strategy of the Bank.

The Board establishes the objectives of the Bank, the adoption and annual review of strategy, the management structure and responsibilities, and the systems and controls framework. It monitors Management performance, and the implementation of strategy by Management, keeps watch over conflicts of interest, and prevents abusive related party transactions.

The Board is also responsible for the preparation and fair representation of the consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal controls as the Board determines is necessary to enable the preparation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

The Board also convenes and prepares the agenda for Shareholders' meetings, and assures equitable treatment of Shareholders including minority Shareholders.

Finally, the Board delegates to Management the responsibility for the day-to-day management of the Bank in accordance with 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 GIB's Articles of Association, the Board plans at least four meetings per year, with further meetings to occur at the discretion of the Board.

The details of Board membership and Directors' attendance during 2017 are set out in the following table:

DIRECTORS' ATTENDANCE JANUARY - DECEMBER 2017

Board members	Board meetings	Executive Committee meetings	Audit Committee meetings	Nomination & Remuneration Committee meetings	Risk Policy Committee meetings	Corporate Governance Committee meetings	Executive / Non-executive	Independent / Non-independent
H.E. Jammaz bin Abdullah Al-Suhaimi, Chairman	2(5)*	1(5)*					Non-Executive	Independent
Dr. Abdullah bin Hassan Alabdulgader	6(6)	6(6)	5(5)			2(2)	Non-Executive	Independent
Mr. Abdulla bin Mohammed Al Zamil	6(6)			6(6)	8(8)	2(2)	Non-Executive	Independent
Mr. Khaled bin Saleh Al-Mudaifer	6(6)		5(5)	6(6)		2(2)	Non-Executive	Independent
Mr. Omar Hadir Al-Farisi	6(6)			6(6)	8(8)		Non-Executive	Independent
Dr. Yahya Abdullah Alyahya	6(6)		5(5)		7(8)		Non-Executive	Independent
Mr. Abdulaziz Al-Helaissi	6(6)	6(6)					Executive	Non-Independent

Figures in (brackets) indicate the maximum number of meetings during the year.
*Indicates the maximum possible number of meetings for the Chairman, prior to his untimely demise in November.

BOARD COMMITTEES

The Committees of the Board derive their authorities and powers from the Board. Details of Committees' membership and attendance are listed in the tables below:

BOARD COMMITTEES' MEMBERSHIP (JANUARY – DECEMBER 2017)

Board committees	Member name	Member position
Executive Committee	H.E. Jammaz bin Abdullah Al-Suhaimi Dr. Abdullah bin Hassan Alabdulgader Mr. Abdulaziz Al-Helaissi	Chairman Member Member
Audit Committee	Dr. Abdullah bin Hassan Alabdulgader Mr. Khaled bin Saleh Al-Mudaifer Dr. Yahya Alyahya	Chairman Member Member
Nomination & Remuneration Committee	Mr. Khaled bin Saleh Al-Mudaifer Mr. Abdulla bin Mohammed Al Zamil Mr. Omar Hadir Al-Farisi	Chairman Member Member
Risk Policy Committee	Mr. Omar Hadir Al-Farisi Mr. Abdulla bin Mohammed Al Zamil Dr. Yahya Alyahya	Chairman Member Member
Corporate Governance Committee	Dr. Abdullah bin Hassan Alabdulgader Mr. Abdulla bin Mohammed Al Zamil Mr. Khaled bin Saleh Al-Mudaifer	Chairman Member Member

BOARD AND COMMITTEES MEETINGS DURING 2017

Type of meeting	Meeting dates
Board Committee	1. 17 February 2017 2. 30 March 2017 3. 27 April 2017 4. 16 July 2017 5. 28 October 2017 6. 15 December 2017
Executive Committee	1. 17 February 2017 2. 30 March 2017 3. 27 April 2017 4. 16 July 2017 5. 28 October 2017 6. 15 December 2017
Audit Committee	1. 16 February 2017 2. 21 April 2017 3. 15 July 2017 4. 27 October 2017 5. 14 December 2017

Type of meeting	Meeting dates
Nomination & Remuneration Committee	1. 16 February 2017 2. 9 March 2017 3. 21 April 2017 4. 15 July 2017 5. 27 October 2017 6. 15 December 2017
Risk Policy Committee	1. 16 February 2017 2. 6 March 2017 3. 30 March 2017 4. 21 April 2017 5. 20 June 2017 6. 15 July 2017 7. 27 October 2017 8. 26 December 2017
Corporate Governance Committee	1. 16 February 2017 2. 15 December 2017

Corporate governance report (continued)

EXECUTIVE COMMITTEE

The mandate of the Executive Committee requires it, among other things, to:

- Assist the Board in formulating the executive policy of the Bank and controlling its implementation.
- Assist the Board by reviewing, evaluating, and making recommendations to the Board with regard to key strategic issues or material changes in key strategic objectives or direction.
- Approve credit limits that exceed the authority of the Group CEO, subject to the limits approved by the Board.
- Carry out additional responsibilities specifically mandated to it by the Board.
- Exercise the powers of the Board on matters for which the Board has not otherwise given specific direction in circumstances in which it is impossible or impractical to convene a meeting of the Board (and subject to applicable law and GIB's Agreement of Establishment & Articles of Association). However, the Board may, acting unanimously, modify or amend any decision of the Committee on such matters.

In all cases, the members of the Committee must exercise their business judgement to act in what they reasonably believe to be in the best interests of the Bank and its Shareholders.

AUDIT COMMITTEE

The role of the Audit Committee is to review the Group's financial position and make recommendations to the Board on financial matters, internal controls, compliance and legal requirements. Its responsibilities include:

- Assisting 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; (iii) the Bank's systems of internal controls; and (iv) the qualifications, independence and performance of the Bank's internal and external auditors.
- Overseeing performance of the Bank's internal audit function and independent audits.

The mandate of the Audit Committee provides further particulars on financial reporting processes, process improvements, and additional ethical and legal compliance overview responsibilities. The Group Chief Auditor reports functionally to the Audit Committee and administratively to the Group CEO.

RISK POLICY COMMITTEE

The Committee assists the Board in fulfilling its oversight responsibilities in respect of setting the overall risk appetite, parameters and limits within which the Bank conducts its activities. On an on-going basis, the Committee:

- Ensures that realistic policies in respect of management of all significant risks are drafted and approved appropriately.
- Receives, reviews, challenges and recommends for approval by the Board any proposed amendments to the overall risk appetite of the Bank.
- Monitors whether Management maintains a culture that rewards the recognition, communication and management of risks.
- Ensures that roles and responsibilities for risk management are clearly defined, with Group and/or division heads directly responsible, and that heads of risk management and the control functions are in supporting or monitoring roles, independent of business development.
- Ensures that Management reports significant excesses and exceptions, as and when they arise, to the Committee for information and review.
- Ensures that, on a timely basis, Management informs the Committee of all significant risks arising, and that it is comfortable with Management's responses and actions taken to address such findings.
- Reviews the Bank's risk profile and significant risk positions and in so doing:
    - Receives reports on credit exposure by country, credit rating, industry/concentration, nonperforming loans and credit stress tests.
    - Receives reports on liquidity and market risk positions (VaR).
    - Receives updates on operational risk management.
    - Receives updates on cyber risks
    - Receives updates on strategic risks
    - Receives reports on changes to credit approvals or extension processes, credit risk measurement, market risk measurement and risk control measures.
    - Receives updates on retail banking risks.

NOMINATION & REMUNERATION COMMITTEE

The principal objective of the Committee is to help the Board with ensuring that the Bank's remuneration levels remain competitive for GIB to continue to attract, retain and motivate competent staff to achieve the strategy and objectives of the Bank. The responsibilities of the Committee, as stated in its mandate, also include, but are not limited to, the following:

Nomination matters:

- Assessing the skills and competencies required on the Board, the Committees of the Board, and Senior Management.
- Assessing from time to time the extent to which the required skills are represented on the Board and Senior Management.
- Establishing processes for reviewing the performance of the individual Directors and the Board as a whole.
- Establishing processes for reviewing the performance of the individual Senior Executives and Senior Management as a whole.
- Overseeing Directors' corporate governance educational activities.
- Establishing processes for the identification of suitable candidates for Senior Management, and identifying and recommending individuals qualified to become members of Senior Management.
- Establishing a succession plan for Senior Management.

Remuneration matters:

- Reviewing and making recommendations to the Board in respect of:
  - The executive remuneration and incentive policy which includes the fixed and variable remuneration for approved persons, and material risk-takers.
  - Policies relating to recruitment, retention, performance measurement and termination for the Directors, the Group CEO and Senior Management.
- Approve, monitor and review the remuneration system to ensure the system operates as intended.
- Approve the remuneration amounts for each approved person and material risk-taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, fees, expenses, bonuses and other employee benefits.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed, including salaries, fees, expenses, bonuses and other employee benefits.

CORPORATE GOVERNANCE COMMITTEE

The role of the Committee is to assist the Board in shaping and monitoring the corporate governance policies. Its responsibilities include:

- Overseeing the development and maintenance of corporate governance policies.
- Monitoring the Bank's compliance with regulatory requirements relating to corporate governance.
- Review mandates and performance evaluations of the Board and its Committees, and recommend to the Board any improvements deemed necessary or desirable to the mandates.
- Review classification of individual Directors, and declaration of Directors and members of Senior Management regarding their outside activities and interests to determine whether any conflict of interest exists, and take appropriate steps in that regard.
- Oversee the Bank's public reporting on corporate governance matters.

EVALUATION OF THE BOARD OF DIRECTORS

The mandates of the Corporate Governance and the Nomination & Remuneration Committees, as well as the Board Charter, reflect the requirement that the Board must conduct an evaluation of its performance, the performance of each Committee and of each individual Director, at least annually. The Board reviewed independent performance reports from each of its Committees as well as a report on its own performance by evaluating the major activities undertaken during the year in comparison with the respective mandates. The evaluation of individual Directors included measurable rating scales, self-evaluations and the Chairman's input. A report on the evaluations conducted each year is also provided to Shareholders at each AGM.

INDUCTION & THE CONTINUING EDUCATION OF DIRECTORS

The Board and its Committees regularly receive updates on key developments in the regulatory and other areas that fall under their responsibilities.

The Board also stresses the importance of providing training and development opportunities for the Directors. The Board has passed a resolution to encourage Directors to seek any training they deem necessary (with the Bank bearing the expenses of such training), and the Directors are frequently briefed on the availability of training opportunities.

Corporate governance report (continued)

MANAGEMENT

The Senior Management team is responsible for the day-to-day management of the Bank entrusted to it by the Board. It is headed by the CEO, who is assisted by the Chief Financial Officer, Chief Risk Officer, Chief Operating Officer, Wholesale Banking Head, Retail Banking Head, Chief Investment and Treasury Officer, Chief Information Officer and Chief Human Resources Officer. The biographies of the key members of the Senior Management team are set out on page 54 of this Annual Report.

The following six committees assist the CEO in the management of the Bank:

- Management Committee
- Group Risk Committee
- Assets and Liabilities Committee (ALCO)
- Job Evaluation Committee
- Information Security Management Committee
- Operational Risk Committee

These Committees derive their authorities from the CEO, based on the authorities and limits delegated by the Board.

In fulfilling its principal responsibility for the day-to-day management of the Bank, the Senior Management team is required to implement Board-approved policies and effective controls, within the strategy and objectives set by the Board.

Letters of appointment are issued to members of the Senior Management team setting out their specific responsibilities and accountabilities that include assisting with and contributing to the following:

- Formulation of the Bank's strategic objectives and direction.
- Formulation of the Bank's annual budget and business plan.
- Ensuring that high-level policies are in place for all areas, and that such policies are fully applied.
- The setting and management of risk/return targets in line with the Bank's overall risk appetite.
- Determining the Bank's overall risk-based performance measurement standards.
- Reviewing business units' performance and initiating appropriate action.
- Ensuring that the Bank operates to the highest ethical standards, and complies with both the letter and spirit of the law, applicable regulations and codes of conduct.
- Ensuring that the Bank is an exemplar of good business practice and customer service.

Their attention is also drawn to the fact that these obligations are in addition to their specific functional responsibilities and objectives, and those set out in the Bank's Corporate Policy Manual.

REMUNERATION

The Bank's total compensation policy, which includes the variable remuneration policy, sets out GIB's policy on remuneration for Directors and Senior Management, and the key factors that were taken into account in setting the policy.

The Bank adopts a Sound Remuneration Practices in accordance to CBB requirements. The Board approved the framework and incentive components, and obtained Shareholder's approval at the 2015 AGM. The key features of the remuneration framework are summarised below.

Remuneration strategy

It is the Bank's basic compensation philosophy to provide a competitive level of total compensation to attract, retain and motivate qualified and competent employees. The Bank's variable remuneration policy is driven primarily by a performance-based culture that aligns employee interests with those of the Shareholders of the Bank. These elements support the achievement of set objectives through balancing reward for both short-term results and long-term sustainable performance. The strategy is designed to share its success and to align employees' incentives with the risk framework and risk outcomes.

The quality and long-term commitment of all employees is fundamental to the success of the Bank. The Bank therefore aims to attract, retain and motivate the very best people who are committed to maintaining a career with GIB, and who will perform their role in the long-term interests of Shareholders. The Bank's reward package comprises the following key elements

- Fixed pay
- Benefits
- Annual performance bonus
- Deferred bonus share plan.

A robust and effective governance framework ensures that the Bank operates within clear parameters of its compensation strategy and policy. All compensation matters, and overall compliance with regulatory requirements, are overseen by the Nomination and Remuneration Committee of the Board ("NRC").

The Bank's remuneration policy, in particular, considers the role of each employee, and has set guidance depending on whether an employee is a Material Risk Taker and/or an Approved Person in business line, control or support functions. An Approved Person is an employee whose appointment would require prior regulatory approval because of the significance of the role within the Bank; and an employee is considered a Material Risk Taker if they head up significant business lines, and any individuals within their control have a material impact on the Bank's risk profile.

In order to ensure alignment between what is paid to employees and the business strategy, GIB assesses Bank-wide, divisional and individual performance against annual and long-term financial and non-financial objectives, summarised in line with the business planning and performance management process. This takes into account adherence to the Bank's values, risk and compliance measures and, above all, acting with integrity. Altogether, performance is therefore judged not only on what is achieved over the short- and long-term, but also importantly on how it is achieved, as the latter contributes to the long-term sustainability of the business.

NRC role and focus

The NRC has oversight of all reward policies for the Bank's employees. The NRC is the supervisory and governing body for compensation policy, practices and plans. It is responsible for determining, reviewing and proposing variable remuneration policy for approval by the Board. It is responsible for setting the principles and governance framework for all compensation decisions. The NRC ensures that all persons must be remunerated fairly and responsibly. The remuneration policy is reviewed on a periodic basis to reflect changes in market practices, and the business plan and risk profile of the Bank.

The aggregate remuneration paid to the NRC members during the year in the form of sitting fees amounted to US$54,000 [2016: US$45,000].

Scope of application of the remuneration policy

The principles of this remuneration policy apply on a Group-wide basis. However, application of deferral requirements and issue of non-cash instruments for foreign branches and subsidiaries of the Bank is determined by applicable local regulations and market norms.

Board remuneration

The Bank's board remuneration is determined by its Shareholders in line with its Articles of Association. The compensation is linked to actual attendance of meetings. The structure and level of the compensation for the members of the Board are approved by the AGM, and consist of the following:

- Attendance fees payable to members attending different Board-related Committee meetings.
- Allowance to cover travelling, accommodation and subsistence, while attending Board and related Committee meetings.
- A pre-defined fixed amount representing an annual remuneration fee.

In 2017, the aggregate remuneration paid to Board members and key Management was US$12.8 million [2016: US$11.2 million] of which US$2.3 million [2016: US$2.9 million] was paid to the Board members.

Variable remuneration for staff

The variable remuneration is performance related, and consists primarily of the annual performance bonus award. As a part of the staff's variable remuneration, the annual bonus reward consists of delivery of operational and financial targets set each year, the individual performance of the employees in achieving those targets, and their contribution to delivering the Bank's strategic objectives.

The Bank has adopted a Board-approved framework to develop a transparent link between variable remuneration and performance. The framework is designed on the basis that the combination of meeting both financial performance and achievement of other non-financial factors would, all other things being equal, deliver a target bonus pool for the employees, prior to consideration of any allocation to business lines and employees individually. In the framework adopted to determine the variable remuneration pool, the NRC aims to balance the distribution of the Bank's profits between Shareholders and employees.

The key performance metrics at the Bank level include a combination of short-term and long-term measures, and include profitability, solvency, liquidity and growth indicators. The performance management process ensures that all goals are appropriately cascaded down to respective business units and employees.

Corporate governance report (continued)

In determining the amount of variable remuneration, the Bank starts from setting specific targets, establishing market comparable bottom-up, setting a profit target and other qualitative performance measures that would result in a target top-down bonus pool. The bonus pool is then adjusted to take account of risk via the use of risk-adjusted measures.

The NRC carefully evaluates practices by which remuneration is paid for potential future revenues whose timing and likelihood remain uncertain. The NRC demonstrates that its decisions are consistent with an assessment of the Bank's financial condition and future prospects.

The Bank uses a formalised and transparent process to adjust the bonus pool for quality of earnings. It is the Bank's objective to pay out bonuses out of realised and sustainable profits. If the quality of earnings is not strong, the profit base could be adjusted based on the discretion of the NRC.

For the Bank to have any funding for distribution of a bonus pool, thresholds of financial targets have to be achieved. The performance measures ensure that the total variable remuneration is generally considerably contracted where subdued or negative financial performance of the Bank occurs. Furthermore, the target bonus pool, as determined above, is subject to risk adjustments in line with the risk adjustment and linkage framework.

Remuneration of control functions
The remuneration level of staff in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel is weighted in favour of fixed remuneration. The variable remuneration of control functions is based on function-specific objectives, and is not to be determined by the individual financial performance of the business area they monitor.

The Bank's performance management system plays a major role in deciding the performance of the support and control units on the basis of the objectives set for them. Such objectives are more focused on non-financial targets that include risk, control, compliance and ethical considerations, as well as the market and regulatory environments, apart from value-adding tasks which are specific to each unit.

Variable remuneration for business units
The variable remuneration for the business units is primarily decided by the key performance objectives set through the performance management system of the Bank. Such objectives contain financial and non-financial targets, including risk control, compliance and ethical considerations, as well as the market and regulatory environments

Risk assessment framework
The risk assessment framework of GIB aligns variable remuneration to the risk profile of the Bank, and also ensures that the remuneration policy reduces employees' incentives to take excessive and undue risk. The Bank considers both quantitative measures and qualitative measures in the risk assessment process, and risk adjustments are applied to ensure that the Bank's remuneration policies are aligned to its risk appetite.

The NRC considers whether the variable remuneration policy is in line with the Bank's risk profile, and ensures that through the ex-ante and ex-post risk assessment framework and processes, remuneration practices where potential future revenues, whose timing and likelihood remain uncertain, are carefully evaluated.

Risk adjustments take into account all types of risks, including intangible and other risks such as reputation risk, liquidity risk and the cost of capital. The Bank undertakes risk assessment to review financial and operational performance against the business strategy and risk performance, prior to distribution of the annual bonus. GIB ensures that total variable remuneration does not limit its ability to strengthen its capital base.

The bonus pool takes into account the performance of the Bank, which is considered within the context of its risk management framework. This ensures that the variable pay pool is shaped by risk considerations and Bank-wide notable events.

The size of the variable remuneration pool and its allocation within the Bank takes into account the full range of current and potential risks, including:

- The capital required to support the risks taken
- The level of liquidity risk assumed in the conduct of business
- Consistency with the timing and likelihood of potential future revenues incorporated into current earnings

The NRC keeps itself abreast of the Bank's performance against the risk management framework. The NRC will use this information when considering remuneration to ensure that return, risk and remuneration are aligned.

Risk adjustments
The Bank has an ex-post risk assessment framework, which is a qualitative assessment to back-test actual performance against risk assumptions.

In years where the Bank suffers material losses in its financial performance, the risk adjustment framework would work as follows:

- There would be considerable contraction of the Bank's total variable remuneration.
- At the individual level, poor performance by the Bank would mean individual KPIs are not met, and hence employee performance ratings would be lower.
- Reduction in value of deferred shares or awards.
- Possible changes in vesting periods, and additional deferral applied to unvested rewards.
- Lastly, if the qualitative and quantitative impact of a loss incident is considered significant, a malus or clawback of previous bonus awards may be considered.

The NRC, with Board approval, can rationalise and make the following discretionary decisions:

- Increase/ reduce the ex-post adjustment
- Consider additional deferrals or increase in the quantum of share awards
- Recovery through malus and clawback arrangements.

Malus and clawback framework
The Bank's malus and clawback provisions allow the NRC to determine that, if appropriate, unvested elements under the deferred bonus plan can be forfeited/adjusted, or the delivered variable remuneration could be recovered in certain situations. The intention is to allow the Bank to respond appropriately if the performance factors, on which reward decisions were based, turn out not to reflect the corresponding performance in the longer term. All deferred remuneration awards contain provisions that enable the Bank to reduce or cancel the awards of employees whose individual behaviour has had a materially detrimental impact on GIB during the concerned performance year. Any decision to take back an individual's award can only be taken by the NRC.

The Bank's malus and clawback provisions allow the Board to determine that, if appropriate, vested/unvested elements under the deferred bonus plan can be adjusted/cancelled in certain situations. These events include, but are not limited to, the following:

- Reasonable evidence of misbehaviour or material error by the employee causing harm to the Bank's reputation, or where the employee's actions have amounted to misconduct, incompetence or negligence.
- The employee's business unit suffers a material downturn in its financial performance, or a material risk management failure, or a material restatement of the financial statements of the Bank.
- The employee deliberately misleads the market and/or Shareholders in relation to the financial performance of the Bank.
- A significant deterioration in the financial health of the Bank, or the relevant line of business incurring losses

Clawback can be used if the malus adjustment on the unvested portion is insufficient, given the nature and magnitude of the issue.

Components of variable remuneration
Variable remuneration has following main components:

Upfront cash	The portion of the variable remuneration that is awarded and paid out in cash on conclusion of the performance evaluation process for each year.
Deferred cash	The portion of variable remuneration that is awarded and paid in cash on a pro-rata basis over a period of 3 years.
Upfront share awards	The portion of variable remuneration that is awarded and issued in the form of shares on conclusion of the performance evaluation process for each year.
Deferred shares	The portion of variable remuneration that is awarded and paid in the form of shares on a pro-rata basis over a period of 3 years.

All deferred awards are subject to malus provisions. All share awards are released to the benefit of the employee after a six-month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of GIB's Share Incentive Scheme. Any dividend on these shares is released to the employee, along with the shares (i.e. after the retention period).

Corporate governance report (continued)

Deferred remuneration

All employees at the grade of 12 (“Grade 12”) and higher shall be subject to deferral of variable remuneration as follows:

Element of variable remuneration	Allocation of variable remuneration: Group CEO, MDs and the 5 most highly-paid business line employees	Allocation of variable remuneration: Grade 12 and higher	Deferral period	Retention	Malus	Clawback
Upfront cash	40%	50%	None	-	-	Yes
Upfront shares	-	10%	None	6 months	Yes	Yes
Deferred cash	10%	-	3 years*	-	Yes	Yes
Deferred share awards	50%	40%	3 years*	6 months	Yes	Yes

* The deferral vests on a pro-rata basis over a 3-year period.

The NRC, based on its assessment of role profiles and risk taken by an employee, could increase the coverage of employees that would subject to deferral arrangements.

Details of remuneration

Board of Directors

US$ 000’s	**2017**	2016
• Remuneration Fees	**1,657**	2,376
• Travel Expenses	**518**	423
• Other Expenses	**110**	125
TOTAL	**2,285**	2,924

Employees

	2017										
		Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					
						Upfront		Deferred			
US$ 000’s	Number of staff	Cash	Others	(Cash / shares)	(Cash / shares)	Cash	Shares[1]	Cash	Shares	Others	Total
Approved persons											
- Business Lines	5	2,741	286	-	-	857	8	204	1,054	-	5,150
- Control & Support	14	3,616	413	-	-	450	58	25	356	-	4,918
Other Material Risk Takers	13	3,041	369	-	-	413	64	23	372	-	4,282
Other Staff	245	25,480	4,524	-	-	2,844	43	-	173	-	33,064
Overseas Staff	850	68,730	13,794	-	-	11,425	-	-	-	-	93,949
TOTAL	**1,127**	**103,608**	**19,386**	**-**	**-**	**15,989**	**173**	**252**	**1,955**	**-**	**141,363**

[1] The upfront shares are vested on grant and paid after six (6) months retention period.

Other staff expenses reported in the consolidated statement of income that have not been included in the table above, amounting to US$1.2 million, comprise indirect staff costs including training, recruitment expenses, life assurance contributions, and differences between accrued staff expenses and the amounts actually paid.

US$ 000's	2016											
	Number of staff	Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration						Total
						Upfront		Deferred				
		Cash	Others	(Cash / shares)	(Cash / shares)	Cash	Shares[1]	Cash	Shares	Others		
Approved persons												
- Business Lines	5	2,649	269	-	-	807	10	189	987	-		4,911
- Control & Support	10	2,421	301	-	-	291	30	29	264	-		3,336
Other Material Risk Takers	8	1,989	219	-	-	223	38	8	192	-		2,669
Other Staff	255	28,690	5,334	-	-	2,880	43	-	172	-		37,119
Overseas Staff	833	65,543	12,676	-	-	9,431	-	-	-	-		87,650
TOTAL	**1,111**	**101,292**	**18,799**	**-**	**-**	**13,632**	**121**	**226**	**1,615**	**-**		**135,685**

[1] The upfront shares are vested on grant and paid after six (6) months retention period.

Other staff expenses reported in the consolidated statement of income that have not been included in the table above, amounting to US$1.3 million, comprise indirect staff costs including training, recruitment expenses, life assurance contributions, and differences between accrued staff expenses and the amounts actually paid.

Deferred Awards

	2017			
	Cash US$ 000's	**Shares**		**Total US$ 000's**
		Number	**US$ 000's**	
Opening balance	375	2,973,830	2,863	3,238
Awarded during the period	226	1,802,515	1,736	1,962
Paid out / released during the period	(153)	(1,316,337)	(1,268)	(1,421)
Service, performance and risk adjustments	-	-	-	-
Corporate action adjustment	-	-	-	-
Changes in value of unvested awards	-	-	87	87
Closing balance*	**448**	**3,460,008**	**3,418**	**3,866**

* Closing balance Share value based on NAV as on 31-12-17

Severance pay

The severance payments during the year amounted to US$79,047 [2016: US$563,419] of which the highest paid to a single person amounted to US$33,302 [2016: US$222,716].

CORPORATE COMMUNICATIONS

The Bank has in place a Corporate Communications Strategy which ensures that the disclosures made by GIB are fair, transparent, comprehensive and timely; and reflect the character of the Bank and the nature, complexity and risks inherent in its business activities. Main communications channels include the website, annual report, corporate brochures, staff newsletters, and announcements in the appropriate media. This transparency is also reflected in the Bank's website (www.gib.com) which provides substantial information on the Bank, including its profile and milestones; vision, mission, values, strategy and objectives; its financial statements for the last five years at least; and its press releases.

Corporate governance report (continued)

CODE OF CONDUCT

The Bank's website also contains the Board-approved Code of Conduct that contains rules on conduct, ethics and on avoiding conflicts of interest, applicable to all the employees and Directors of the Bank. The Code of Conduct is designed to guide all employees and Directors through best practices to fulfil their responsibilities and obligations towards the Bank's stakeholders (Shareholders, clients, staff, regulators, suppliers, the public, and the host countries in which the Bank conducts business, etc.), in compliance with all applicable laws and regulations.

The Code addresses such issues as upholding the law and following best practices; acting responsibly, honestly, fairly and ethically; avoiding conflicts of interest; protecting Bank property and data; protecting client-confidential information and safeguarding the information of others; complying with inside information rules and with the prohibition on insider trading; preventing money laundering and terrorism financing; rejecting bribery and corruption; avoiding compromising gifts; as well as speaking up and 'whistle blowing'.

All employees and Directors of the Bank are reminded every year of their obligations under the Code of Conduct by means of an email from the Bank that includes a copy of the Code of Conduct (in English and Arabic), and everyone is required to sign an Acknowledgment and Declaration confirming that they have received and read the Code of Conduct and understand its requirements; have followed and will continue to follow these requirements; and agree that if they have any concern about any possible misconduct or breach of the Code of Conduct, they will raise the concern with the appropriate persons within the Bank as per the Code.

In addition, all employees of the Bank must sign an annual Declaration on outside employment and other activities, to ensure that no conflicts of interest exist. These Declarations are addressed to the Bank's Human Resources department. Similarly, all Directors and members of the Management Committee must complete and sign a similar annual Declaration, addressed to the Corporate Governance Committee of the Board.

DISCLOSURES

The Bank's website also provides access to GIB's annual reports, and all the information contained in these reports is therefore accessible globally. The 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 Financial Reporting Standards that were applicable for adoption in 2017.

The Board-approved Disclosure Policy is in accordance with the requirements of Basel 3 Pillar 3, in compliance with CBB rules. The objective of this policy is to ensure transparency in the disclosure of the financial and risk profiles of the Bank to all interested parties.

POLICY ON CONNECTED COUNTERPARTIES

The Board-approved Policy on Connected Counterparties governs GIB's dealings with such parties. The policy defines which parties are considered to be connected with GIB within the criteria set by the CBB, and imposes not only the limitations placed by the CBB but also additional criteria imposed by GIB. The policy sets out the internal responsibilities for reporting GIB's connected counterparties exposures to the CBB, and the disclosures to be made in GIB's financial statements and annual reports, in line with applicable disclosure requirements.

POLICY ON RELATED PARTY TRANSACTIONS

GIB has a Board-approved Code of Conduct which governs the conflict of interests and related party transactions. The Bank's dealings with its Shareholders are conducted on an arms-length basis in respect of its exposure to and deposits received from them. If loans are extended to related parties, these are approved on the basis of authorities delegated by the Board to the Group CEO. If the loans exceed these authorities, then further approval from the Executive Committee or the Board is requested. The Bank will not deal with any of its Directors in a lending capacity. It should be noted that Article 16 of the Articles of Association prevents Directors of the Bank from having any interest, directly or indirectly, in any contract with the Bank.

All loans to Senior Management members (including the CEO and his direct reports), as well as staff of GIB, are governed by the policies applicable to staff. These policies are reviewed by the Nomination & Remuneration Committee of the Board at least annually. All dealings with companies associated with a GIB Director or member of the Senior Management are referred to the Board for approval.

MATERIAL TRANSACTIONS THAT REQUIRE BOARD APPROVAL

The Bank has delegated credit authority to the Group CEO based on a risk-rating matrix. When considering transactions, any exposure to an entity that exceeds the Group CEO's limit will require the approval of the Board Executive Committee or the Board.

COMPLIANCE

The Compliance framework adopted by the Board reflects the principles for promoting sound compliance practices at GIB. It also demonstrates the Bank's adherence to applicable legal and regulatory requirements, and to high professional standards. The role of the Compliance function is to assist Senior Management in ensuring that the activities of GIB and its staff are conducted in conformity with applicable laws and regulations, and generally with sound practices pertinent to those activities. The Group Head of Compliance & Corporate Governance, who reports directly to the Group CEO, also has access to the Board through the Audit & Corporate Governance Committees, if required.

Compliance risk is the risk of legal or regulatory sanctions, material financial loss or damage to the reputation of the Bank arising from failure to comply with the requirements of applicable laws, rules, regulations and related self-regulatory organisations' standards and codes of conduct (collectively, applicable laws, rules and regulations). Group Compliance independently assesses compliance risk, and evaluates the business and control units for adherence to applicable laws, rules and regulations, including identifying compliance issues and risks, performing independent spot checks, and reporting on the state of compliance activities across the Bank.

The Bank's approach to the management of compliance risk is described in the Group Compliance Policy, which outlines the requirements of the Bank's group compliance programme, and defines roles and responsibilities of Board, Senior Management, Business and Control units, Internal Audit, and the three lines of defence in managing compliance risk. The requirements work together to drive a comprehensive risk-based approach for the proactive identification, management and escalation of compliance risks throughout the Bank.

The Group Compliance Policy also sets the requirements for reporting compliance risk information to Executive Management as well as the Board or appropriate Board level committees in support of Group Compliance responsibility for conducting independent oversight of the Bank's compliance risk management activities. The Board provides oversight of compliance risk mainly through its Audit Committee and the Corporate Governance Committee.

In ensuring that the tone emanates from the top, the Group CEO issues a yearly message to all of GIB employees reminding everyone of the importance of complying with all laws and regulations applicable to GIB's operations. Good compliance behaviour is also rewarded by making it a mandatory measurement criteria in staff evaluations.

ANTI-MONEY LAUNDERING

The Bank's current Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) procedures and guidelines conform to the legal and regulatory requirements of the Kingdom of Bahrain. These legal and regulatory requirements largely reflect the FATF recommendations on Money Laundering. GIB's AML/CFT procedures and guidelines apply to all of the Bank's offices, branches and subsidiaries, wherever located. In addition, the GIB entities located outside Bahrain are subject to the laws and requirements of the jurisdictions where they operate, and if local standards differ, the higher standards apply.

Systems are in place to ensure that business relationships are commenced with clients whose identity and activities can reasonably be established to be legitimate; to collect and record all relevant client information; to monitor and report suspicious transactions; to provide periodic AML/CFT training to employees; and to review with external auditors the effectiveness of the AML/CFT procedures and controls. The Bank's AML/CFT procedures prohibit dealing with shell banks. A proactive structure of officers is in place to ensure Group-wide compliance with AML/CFT procedures, and the timely update of the same to reflect the changes in regulatory requirements. This structure consists of the Group Head of Compliance and the Group Money Laundering Reporting Officer, MLROs, and Deputy MLROs.

CORPORATE GOVERNANCE FRAMEWORK – AUDIT

The Internal Audit review of the Bank's Corporate Governance framework is conducted annually as a separate project since the introduction of the Corporate Governance Rules in 2010. Accordingly, the latest audit was undertaken in October 2017. The purpose of the audit was to provide a level of assurance about the processes of corporate governance within the Bank. The scope of the audit included reviewing the existing policies, procedures and current practices followed by GIB in light of the CBB rules contained in the HC Module of the CBB Rulebook.

The overall conclusion of the audit was that the Corporate Governance framework of GIB appears to be operating effectively, and is providing a sound framework to control the risks inherent in GIB's current business activities.

STATUS OF COMPLIANCE WITH THE CBB RULES (MODULE HC)

GIB is in compliance with the CBB rules on Corporate Governance outlined in Module HC of the CBB Rulebook, and instances of non-compliance in 2017 are explained as follows:

Module HC 7.2.2 requires all Directors to attend and be available to answer questions from Shareholders at any Shareholder meeting.

In addition, Module HC 1.3.4 - 1.3.6 which requires Directors to attend at least 75% of all Board meetings in a given financial year, the late Chairman of Board was unable to attend more than 50% of the meetings held in 2017 due to medical issues.

Under Article 2 of GIB's Agreement of Establishment approved by Decree Law No. (30) for the year 1975 (as amended from time to time) (the "Agreement of Establishment"), GIB is subject to the Agreement of Establishment and its AoA (together the "GIB Constitutional Documents"), and in the event of any conflict between the GIB Constitutional Documents and the internal law of the Kingdom of Bahrain, the terms of the Constitutional Documents shall prevail. As a result, certain Corporate Governance requirements under HC-1, HC-4 and HC-5 that are in conflict with the AoA such as the nomination of Directors, the attendance requirements for Directors, the prohibition against proxies at Board Meetings, and the Board of Directors total remuneration, have not been adopted.

Board of Directors biographies

1. Dr. Abdullah bin Hassan Alabdulgader (1) (5)
Elected Chairman on 15 December 2017
Director since 2009
Kingdom of Saudi Arabia

Dr. Abdullah bin Hassan Alabdulgader is an independent consultant. He is Chairman of Saudi Telecom Company (STC), and also serves as Director of Saudi Arabian Investment Company (Sanabil), Saudi Arabian Railroads Company (SAR), and AlFaisaliah Group. Prior to this, he was Professor of Business Administration at King Fahd University of Petroleum and Minerals; and a Commissioner at the Saudi Capital Market Authority, where he led development of the Kingdom's corporate governance code. As a Founding Executive Director of the GCC Board Directors Institute, he continued to promote corporate governance in the region. Dr. Alabdulgader holds a PhD in Business Administration from the University of Colorado Boulder, USA; and MBA and BSc degrees in Business Administration from King Fahd University of Petroleum and Minerals. He has 36 years' professional experience.

2. Mr. Khaled bin Saleh Al-Mudaifer (2) (3) (5)
Elected Vice Chairman on 15 December 2017
Director since 2009
Kingdom of Saudi Arabia

Mr. Khaled bin Saleh Al-Mudaifer is President and Chief Executive Officer of Saudi Arabian Mining Company (Ma'aden), where he was previously Vice President for Phosphate & New Business Development, and Vice President for Industrial Affairs. Prior to that, he was Managing Director of Qassim Cement Company; and Vice President - Finance at Eastern Petrochemical Company (Sharq), a SABIC affiliate. He is a Board and Executive Committee Member of Ma'aden; and an ex-Board Member of Qassim Cement Company, and Saudi Arabian Railway Company. Mr. Al-Mudaifer holds MBA and BSc degrees in Engineering from King Fahd University of Petroleum and Minerals, Saudi Arabia. He has 33 years' professional experience.

3. Mr. Abdulla bin Mohammed Al Zamil (3) (4) (5)
Director since 2009
Kingdom of Saudi Arabia

Mr. Abdulla bin Mohammed Al Zamil is Board Member and Chief Executive Officer of Zamil Industrial Investment Company, having previously served as Chief Operating Officer. Prior to this, he was Senior Vice President at Zamil Air Conditioners, where he started his career as an industrial engineer. He is Chairman of GIB Capital, Saudi Global Ports & Dammam Airports Company (DACO). Mr. Al Zamil's board memberships include Gulf International Bank (UK) Limited, Gulf Insulation Group (GIG), Ranco-Zamil Concrete Industries, and Viva Bahrain. Board memberships of government entities include the Eastern Province Council, General Authority of Civil Aviation, King Fahd Specialised Hospital; as well as non-profit organisations including Saudi Food Bank (Etaam), Endeavor - Saudi Arabia, and Dhahran Ahliyya School. Mr. Al Zamil holds an MBA (with a concentration in Finance) from King Fahd University of Petroleum and Minerals, Saudi Arabia; and a Bachelor's degree in Industrial Engineering from the University of Washington, USA. He has 31 years' professional experience.

4. Mr. Omar Hadir Al-Farisi (2) (3) (4)
Director since 2012
United States of America

Mr. Omar Hadir Al-Farisi is Managing Member of Diyala Advisors in New York. Previously, he was an investment banker at Credit Suisse First Boston in New York, where he focused on energy sector financings, mergers and acquisitions, and related transactions. Prior to his career in banking, he was an attorney at the law firm of White & Case in New York, where he was a member of the Corporate & Financial Services Department. Mr. Al-Farisi holds a Doctor of Jurisprudence (JD) degree from Columbia University School of Law, USA; and a BA in Economics from the University of Notre Dame, USA. He has 24 years' professional experience.

1 2 3

4 5 6

(1) Executive Committee member
(2) Audit Committee member
(3) Nomination & Remuneration Committee member
(4) Risk Policy Committee member
(5) Corporate Governance Committee member

5. Dr. Yahya A. Alyahya (1) (2) (4)
Director since 2015
Kingdom of Saudi Arabia

Dr. Yahya A. Alyahya served as Chief Executive Officer of Gulf International Bank from January 2009 to February 2016. Prior to this, he represented Saudi Arabia as Executive Director on the Board of the World Bank Group, where he held several prominent positions. Earlier, he was Advisor to the Governor of the Saudi Arabian Monetary Agency; and Founder and Director General of the Institute of Banking, Riyadh, Saudi Arabia. He was also Professor of Industrial and Systems Engineering at King Saud University, Saudi Arabia, and the University of Michigan, USA; and Lecturer on Matching Problems and Algorithms at the Indian Statistical Institute, Bangalore, India. Dr. Alyahya is a Member of the Conciliation and Arbitration Panels of the International Center for Settlement of Investment Disputes (ICSID). Previous board memberships include the Group of Twenty (G20) High Level Panel on Infrastructure Investment, and Member and Co-Chairman of the Emerging Markets Advisory Council (EMAC). Dr. Alyahya holds a PhD in Industrial and Systems Engineering from the University of Michigan, USA; and graduated from King Fahd University of Petroleum and Minerals, Saudi Arabia. He has 43 years' professional experience.

6. Mr. Abdulaziz A. Al-Helaissi (1)
Director since 2016
Group Chief Executive Officer, Gulf International Bank
Chairman, Gulf International Bank (UK) Limited
Kingdom of Saudi Arabia

Mr. Abdulaziz Al-Helaissi was appointed Group Chief Executive Officer of Gulf International Bank on 1st February 2016. He was previously Deputy Governor for Supervision at the Saudi Arabian Monetary Authority (SAMA), having started there in 2013. At SAMA, his responsibilities included oversight of the banking, insurance and Finance Company sectors (mortgages, leasing and other non-bank finance institutions). He was additionally responsible for consumer protection. Prior to SAMA, Mr. Al-Helaissi was Senior Country Officer and Managing Director for JPMorgan Chase, as well as Head of Global Corporate Banking for the MENA region between September 2010 and May 2013. Earlier in his career, he was Central Province Area General Manager at Saudi British Bank (SABB), an affiliate of HSBC, covering all key lines of business including corporate and consumer banking. He is the Chairman of Gulf International Bank (UK) Limited and Board Member of GIB Capital. He previously served on the Board of the Saudi Stock Exchange (Tadawul). Mr. Al-Helaissi holds a BA in Economics from the University of Texas, Austin, USA. He attended the International Executive Programme at INSEAD, France; and the Advanced Management Program at Wharton Business School, University of Pennsylvania, USA. He has 28 years' professional experience.

Senior management biographies

Abdulaziz A. Al-Helaissi
Group Chief Executive Officer & Board Member
Chairman – Gulf International Bank (UK) Limited
Member of Board Executive Committee and Chairman of Management Committee

Abdulaziz Al-Helaissi has 28 years' banking and regulatory experience, primarily in the Kingdom of Saudi Arabia. He joined GIB in his current position in February 2016. Prior to this, he was Deputy Governor for Supervision at the Saudi Arabian Monetary Authority (SAMA), where he started in May 2013. His responsibilities included oversight of the banking and insurance sectors, together with finance company regulation (mortgages, leasing and other non-bank finance institutions) and consumer protection. Prior to joining SAMA, Abdulaziz was Senior Country Officer and Managing Director - Saudi Arabia, and Head of Global Corporate Banking - Middle East & North Africa, for JPMorgan Chase between September 2010 and May 2013. Earlier in his career, he was Area General Manager - Central Province at Saudi British Bank (SABB), an affiliate of HSBC, covering all lines of business including corporate and consumer banking. His various board memberships have included Tadawul (Saudi Stock Exchange). Abdulaziz holds a Bachelor of Arts degree in Economics from the University of Texas in Austin, USA.

Mushari Al Otaibi
Group Chief Operating Officer and Country Head, Saudi Arabia
Chairman of KSA Management Committee, and Member of Management Committee, Human Resources Committee, Operational Risk Management Committee and Information Security Committee

Mushari Al Otaibi has over 26 years' experience in the areas of back office operations, human resources, retail banking and wealth management. He joined GIB as Deputy Chief Operating Officer and Country Head, Saudi Arabia in August 2016, and was promoted to his current position in February 2018. As COO, he is responsible for Group Operations, Information Technology, Administration, Procurement, Corporate Communications and the Strategy Management Office & Centre of Excellence. Prior to joining GIB, Mushari was General Manager - Operations & Processing at Saudi British Bank (SABB) in Saudi Arabia. During his 25 years with SABB, he held a number of positions with executive management responsibility across key areas of the bank. These include Head of Human Resources Relationship Management, Regional Head of Retail Banking & Wealth Management, Senior Executive - Network Services & Processing, and Deputy Head of the Credit Cards Centre. Mushari attended the High Performers Leadership Programme at INSEAD, France.

Stephen D. Williams
Group Chief Financial Officer
Member of the Management Committee, Human Resources Committee, Assets & Liabilities Committee, Group Risk Committee, Operational Risk Management Committee, and Information Security Management Committee

Stephen Williams has 37 years' international experience in banking, accountancy and audit. Joining GIB in 1987, he was appointed Group Financial Controller in 2000, and assumed his current position as Chief Financial Officer in April 2008. Stephen is responsible for Group-wide statutory, regulatory and management reporting; financial and balance sheet planning; capital management; and Basel Committee guidelines implementation. Prior to joining GIB, he worked for KPMG in London and the Middle East. A certified Chartered Accountant and Member of the Institute of Chartered Accountants in England and Wales (ICAEW), Stephen is the Bahrain country representative for the ICAEW. He holds a BSc degree in Economics from Cardiff University, UK; and is a Member of the Working Groups on Capital Adequacy and Working Liquidity at the Institute of International Finance.

Masood Zafar
Group Chief Risk Officer
Member of Management Committee, Human Resources Committee, Assets & Liabilities Committee, Group Risk Committee, Operational Risk Management Committee and Information Security Committee

Masood Zafar has 38 years' international experience in banking, accountancy, audit and risk management. Joining GIB in 1982 in the Internal Audit department, he was subsequently appointed Chief Internal Auditor in 1987 and Chief Credit Officer in 2004. He assumed his current position in July 2012. Prior to joining GIB, Masood worked at Ernst & Young in London and KPMG in Bahrain. He is a Fellow of the Institute of Chartered Accountants in England and Wales.

Steven J. Moulder
Group Chief Investment & Treasury Officer
Member of Management Committee, Human Resources Committee, Assets and Liabilities Committee, Operational Risk Management Committee and Information Security Committee

Steven Moulder has 37 years' international experience in banking and treasury. He started his career with GIB in 1987 as a Senior Dealer Foreign Exchange at the London Branch. In 1997, he was appointed Head of Treasury and then in 2000, Head of Treasury & Banking Services at the newly-established GIB (UK) Limited. Steven moved to GIB Bahrain in 2009 as

Head of Treasury Capital Markets, and was appointed Acting Chief Investment & Treasury Officer in 2015. He assumed his current position in June 2016. Prior to joining GIB, he was a Foreign Exchange Dealer with the London branches of Crocker National Bank, ABN Bank and Bank of New Zealand. Steven attended the Advanced Development Programme at Cranfield University School of Management, UK.

Helen Janet Lloyd
Group Chief Human Resources Officer
Member of Management Committee, Human Resources Committee and Information Security Committee

Helen Lloyd has over 30 years' international experience in human resources development, learning and cultural transformation. She joined GIB in her current position in April 2017. Prior to this, Helen worked at RSA Group PLC where she was HR Director - UK and International. Previously, Helen was AGM - Organisational Effectiveness at Commercial Bank of Qatar; and she spent six years at Lloyds Banking Group PLC, latterly as Head of HR, Commercial Banking. She also worked for Grupo Santander in the UK, where she held the positions of Head of Learning, Head of Performance Development, and Human Resources Manager. In her early career, she worked for Standard Bank of South Africa in a number of HR-related roles. Helen holds an MBA from Heriot-Watt University, UK; and a BA from the University of South Africa (UNISA). She attended the Management Development Programme at UNISA School of Business Leadership.

Stephen Whitaker
Group Chief Information Officer
Member of Management Committee, Human Resources Committee, Operational Risk Management Committee and Information Security Committee

Stephen Whitaker has over 24 years' international financial markets experience in information technology; and in delivering complex change programmes across both business and technology. He joined GIB in his current position in October 2016. Prior to this, Stephen was EMEA Head of Technology Delivery Services for FIS – the world's largest global fintech dedicated to banking technology solutions – where he built the first UK banking utility that supports the first digital-only bank in the UK. Previously, he was a Managing Director at the Royal Bank of Scotland (RBS) where he held various roles over a ten-year period; these including Head of Technology for Williams & Glyn, and Head of Western Europe Integration (RBS and ABN Amro). Stephen was also responsible for the oversight of all non-core Whole Business and Country divestment executions. Before this, he was an Executive Director at ABN Amro, where his roles included Global Head of Commercial Banking Technology, and Head of EU Consumer & Commercial Technology. He started his career at Andersen Consulting, focused on financial markets. Stephen holds an MA degree in Electrical & Information Services from Queens' College, University of Cambridge, UK.

Yasser A. Al-Anssari
Group Compliance and Governance Head & Group MLRO
Secretary of the Board Corporate Governance Committee, Member of Management Committee, Operational Risk Management Committee and Information Security Committee

Yasser Al-Anssari has over 19 years' experience in the field of compliance and governance in the Kingdom of Saudi Arabia, at a government level and with international and domestic banks. He joined GIB in his current position in May 2016. Prior to this, Yasser was Advisor to the Saudi Arabian Civil Service Minister on Compliance & Governance Affairs. Previously, he was Global Chief Compliance Officer with Al Rajhi Bank; Head of Compliance & AML at the Riyadh branch of JPMorgan Chase Bank; Country Head of Compliance & AML Manager at the Riyadh branch of BNP Paribas; and Compliance Manager at Saudi Hollandi Bank. During the early stages of his career, he worked at Samba Financial Group and Riyadh Bank in various credit control, risk management and compliance positions. Yasser holds a Bachelor's degree in Management with Compliance from the University of Manchester, UK. He is a Certified Compliance Officer (Institute of Banking - Saudi Arabian Monetary Authority); a Certified Anti-Money Laundering Specialist (CAMS); and holds two Graduate Diplomas in Anti-Money Laundering and International Compliance from the International Compliance Association.

Senior management biographies (continued)

Khalid M. Mahmood
Group Chief Auditor
Secretary of the Board Audit Committee

Khalid Mahmood has over 32 years' experience in banking, regulatory compliance and audit. Joining GIB's Internal Audit department in 1987, he was appointed Head of Financial Audit in 2004 and Acting Group Chief Auditor in 2010. He was then appointed Group Head of Compliance & Group MLRO in 2012, before taking up his current position in May 2016. Prior to joining GIB, he worked with KPMG in Bahrain. Khalid holds an Associated Accounting Diploma from University of Bahrain; and attended the Gulf Executive Program at Darden School of Business, University of Virginia, USA.

Ravi Krishnan
Group Wholesale Banking Head
Member of Management Committee, Assets & Liabilities Committee, Operational Risk Management Committee and Information Security Committee

Ravi Krishnan has over 17 years' banking experience in the GCC. Joining GIB in 2004 in the Project Finance division, he was subsequently appointed Head of Project Advisory, Head of Credit Products, and Head of Relationship Management for GCC and International Markets. He was appointed Acting Head of Wholesale Banking in 2015, and assumed his current position in November 2016. Prior to joining GIB, Ravi worked with Arab Petroleum Investments Corporation (APICORP) in Saudi Arabia as a member of the Project Finance team. Previously, he was a Management Consultant with KPMG in the UK and Bahrain. Ravi is a Fellow of the Institute of Chartered Accountants of India; and a Member of the Institute of Cost & Works Accountants of India, and the Institute of Company Secretaries in India.

Mohammed Salim Algarni
Group Head of Retail Banking
Member of Management Committee

Mohammed Algarni has spent over 15 years in the financial services industry, with particular experience in channel management, e-commerce and payments. He joined GIB in his current position in April 2017. Prior to this, he was Vice President - Digital Products & Marketing at Takamol Holding, Saudi Arabia. Previously, he spent 11 years with Al Rajhi Bank, Saudi Arabia, where his final position was AGM - Head of Direct Banking. Earlier in his career, he was Sales Manager at Arabian Business Machines, Olayan Group, Saudi Arabia. Mohammed holds a Master's degree in Marketing from the Newcastle University Business School, UK; and a Bachelor's degree in Marketing from the College of Industrial Management, King Fahd University of Petroleum and Minerals, Saudi Arabia.

Ali Riad Achkar
Head of Strategy Management Office & Centre of Excellence
Member of Management Committee, Change Control Committee, Strategy Execution Steering Committee and Innovation Committee; and attends Board Executive Committee

Ali Achkar has over 19 years' professional experience, of which the past 13 have been spent in the MENA region, focused on the financial services sector. His experience primarily embraces strategy formulation, articulation and implementation; leading transformations (digital and non-digital) and launching start-ups; as well as restructuring human resources functions. Since joining GIB in 2010, Ali has headed the Strategy Management Office & Centre of Excellence, through which he has steered the Bank's strategy and business model transformation; along with the conceptualisation and launch of GIB's new digital retail bank 'meem'. He continues to support the Bank's strategic evolution, which includes the Group-wide innovation agenda; together with leading key pan-GCC initiatives. Prior to joining GIB, Ali worked in a number of executive positions within the MENA region with institutions including Dubai Islamic Bank and Nobles Investments in Dubai, and Global Banking Corporation in Bahrain. He holds a Bachelor's degree in Business Administration from University of Detroit Mercy, USA.

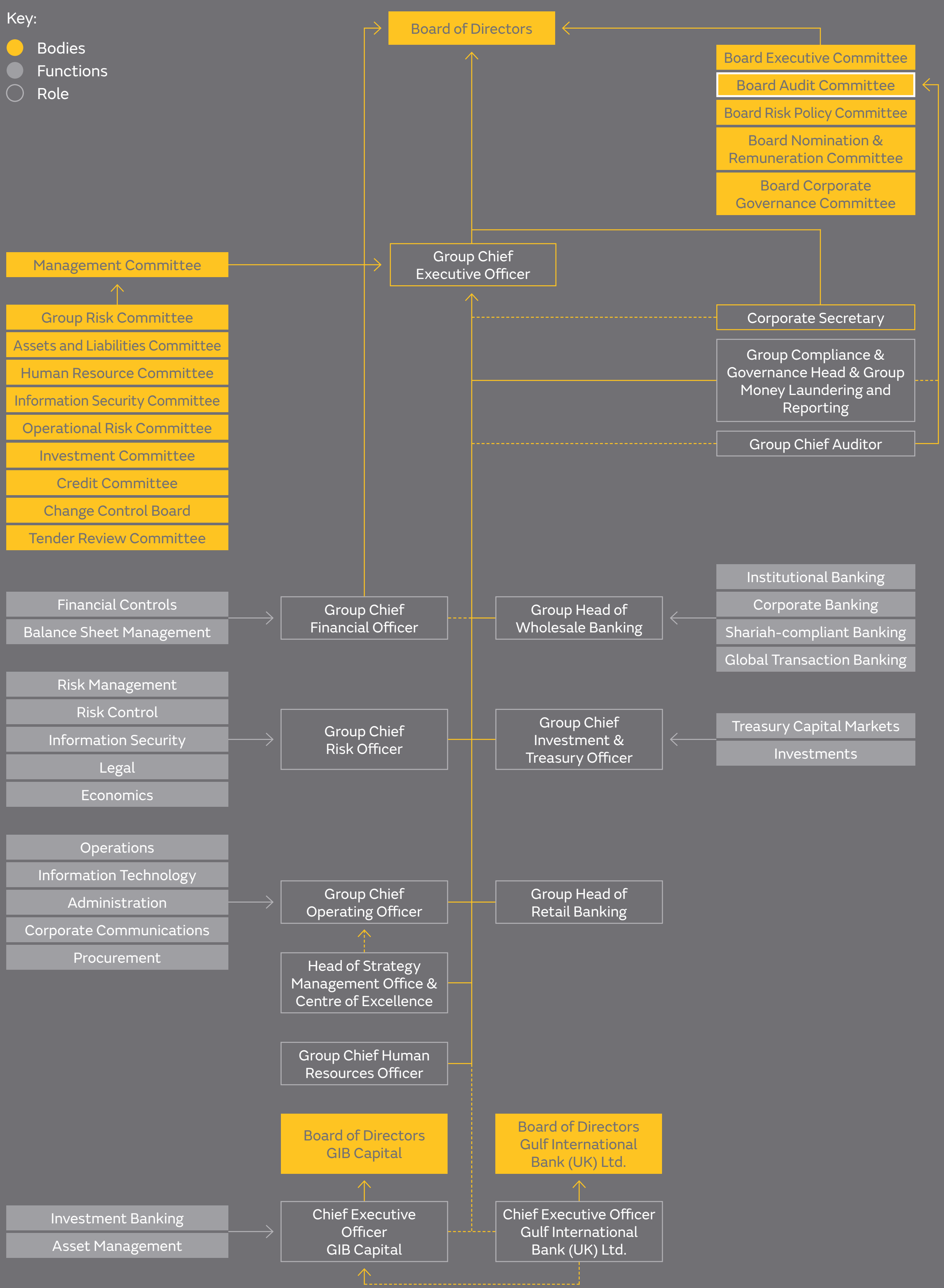
Katherine Garrett-Cox
Managing Director and Chief Executive Officer
Gulf International Bank (UK) Limited
Member of Management Committee and Investment Committee

Katherine Garrett-Cox has over 28 years' experience in the global asset management industry, managing institutional and retail funds across a broad range of investment disciplines. Katherine joined GIB UK in her current position in October 2017. Prior to this, she was Chief Executive Officer and Executive Director of Alliance Trust PLC. She previously served as Chief Investment Officer and Executive Director of Morley Fund Management (now Aviva Investors); and Chief Investment Officer of Aberdeen Asset Management PLC. Katherine is a Member of the Supervisory Board of Deutsche Bank AG; and previously served as a member of the UK Prime Minister's Business Advisory Group and the Scottish Business Board. She was awarded a CBE in 2014 for services to the asset management industry, and charitable services through the Baring Foundation. Katherine is a Fellow of the Thunderbird School of Global Management, USA; and a member of the UK Society of Investment Professionals, CFA Institute. She holds a BA Honours degree in History from Durham University, UK; and studied Leadership and Public Policy for the 21st Century at John F. Kennedy School of Government, Harvard University, USA.

Osamah Mohammed Shaker
Chief Executive Officer - GIB Capital
Member of Management Committee and Investment Committee

Osamah Mohammed Shaker has over 19 years' experience in investment banking, asset management and banking regulatory control. He joined GIB in his current position in June 2016. Prior to this, Osamah was Director General of Banking Control at the Saudi Arabian Monetary Authority (SAMA), responsible for overseeing and regulating all commercial banks in the Kingdom; and was also a Senior Advisor to the Deputy Governor of SAMA. Previously, he gained over 16 years' experience in banking and investments with the Saudi British Bank (SABB) and HSBC Saudi Arabia. With the latter, Osamah held executive level positions as Managing Director - Head of Financial Markets, and Managing Director - Head of Investments. He was also a Faculty Member at the Institute of Public Administration in Riyadh, Saudi Arabia, where he taught Statistics and also provided statistical consultation. Osamah holds a Master of Science degree in Statistics from Colorado State University, USA; and a Bachelor of Administrative Science degree in Quantitative Methods, from King Saud University, Riyadh, Kingdom of Saudi Arabia.

Organisation and corporate governance chart



Consolidated financial statements

For the year ended 31st December 2017

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Independent auditors' report to the shareholders of Gulf International Bank B.S.C.

Report on the Audit of the Consolidated Financial Statements

Opinion
We have audited the accompanying consolidated financial statements of Gulf International Bank B.S.C. ("the Bank") and its subsidiaries (together "the Group"), which comprise the consolidated statement of financial position as at 31 December 2017, and the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017, and its consolidated financial performance and consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

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

Key audit matters
Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the year ended 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

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

Impairment of loans and advances under IFRS9

Key audit matter	How the key audit matter was addressed in the audit
The Group impairment provision exercise for loans and advances involves significant judgment using subjective assumptions over both when and how much to record as loan impairment. Loans and advances form a major portion of the Group's assets. There is a risk that inappropriate impairment provisions are booked, whether from the use of inaccurate underlying data, or the use of unreasonable assumptions. Due to the significance of the judgments used in classifying loans and advances into various stages stipulated in IFRS 9 and determining related provision requirements, this audit area is considered a key audit risk. As at 31 December 2017, the Group's gross loans and advances amounted to US$10,456.7 million and the related impairment provisions amounted to US$413.6 million, comprising US$152.6 million of provision against Stage 1 and 2 exposures and US$261 million against exposures classified under Stage 3. The impairment provision policy is presented in the accounting policies, and in Note 26 to the consolidated financial statements.	• We gained an understanding of the Group's key credit processes comprising granting, booking, monitoring and provisioning and tested the operating effectiveness of key controls over these processes • We read the Group's IFRS 9 impairment provisioning policy and compared it with the requirements of IFRS 9 as well as relevant regulatory guidelines and pronouncements **Stage 1 and Stage 2 Provisions:** • For provision against exposures classified as Stage 1 and Stage 2, we obtained an understanding of the Group's provisioning methodology, the underlying assumptions and the sufficiency of the data used by management • We obtained an understanding of the Group's internal rating model for loans and advances and read the annual validation report on internal rating. This has provided comfort that the discrimination power and calibration of the rating model is appropriate. Further, we performed procedures to assess the competence, objectivity and independence of the external and internal experts involved in this exercise • We checked the appropriateness of the Group's determination of significant increase in credit risk and the resultant basis for classification of exposures into various stages

Independent auditors' report to the shareholders of Gulf International Bank B.S.C. (continued)

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

Key audit matters (continued)

Impairment of loans and advances under IFRS9	
Key audit matter	**How the key audit matter was addressed in the audit**
	▪ For a sample of exposures, we checked the appropriateness of the Group's staging ▪ For forward looking assumptions used by the Group in its Expected Credit Loss ("ECL") calculations, we held discussions with management and corroborated the assumptions using publicly available information ▪ For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of repayments in the cash flows and the resultant arithmetical calculations ▪ For Probability of Default ("PD") used in the ECL calculations we checked the Through the Cycle ("TTC") PDs with external published data and checked the appropriateness of conversion of the TTC PDs to Point in Time PDs ▪ We checked that the Loss Given Defaults used by the Group's management in the ECL calculations were appropriate ▪ We checked the completeness of loans and advances, credit related contingent items, investment securities and placements included in the ECL calculations as of 31 December 2017 ▪ We understood the theoretical soundness and mathematical integrity of the ECL Model ▪ For data from external sources, we understood the process of choosing such data, its relevance for the Group, and the controls and governance over such data ▪ Where relevant, we used Information System specialists to gain comfort on data integrity ▪ We assessed the financial statement disclosures to ensure compliance with IFRS 9. Refer to the accounting policies, critical accounting estimates and judgments, disclosures of loans and advances and credit risk management in notes 2, 3, 10 and 26 respectively to the consolidated financial statements. **Stage 3 (Specific) Provisions:** ▪ For exposures determined to be individually impaired, we obtained an understanding of the latest developments in the counterparty's situation and examined management's estimate of future cash flows and checked the resultant provision calculations. For each exposure selected, we reperformed the provision calculation by considering alternative scenarios and benchmarking the provision held to that across the industry

Independent auditors' report to the shareholders of Gulf International Bank B.S.C. (continued)

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

Other information included in the Group's 2017 Annual Report
Other information consists of the information included in the Group's 2017 Annual Report, other than the consolidated financial statements and our auditor's report thereon. The Board of Directors is responsible for the other information. Prior to the date of this auditor's report, we obtained the Chairman's Statement which will form part of the annual report, and the remaining sections of the annual report are expected to be made available to us after that date.

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

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

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

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

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Board of Directors.

- Conclude on the appropriateness of the Board of Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

Independent auditors' report to the shareholders of Gulf International Bank B.S.C. (continued)

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

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

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with the Group's Audit Committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

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

Report on Other Legal and Regulatory Requirements

As required by the Bahrain Commercial Companies Law and Volume 1 of the Central Bank of Bahrain (CBB) Rule Book, we report that:

a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;

b) the financial information contained in the Chairman's Statement is consistent with the consolidated financial statements;

c) we are not aware of any violations of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1 and applicable provisions of Volume 6) and CBB directives, or the terms of the Bank's memorandum and articles of association during the year ended 31 December 2017 that might have had a material adverse effect on the business of the Bank or on its consolidated financial position; and

d) satisfactory explanations and information have been provided to us by management in response to all our requests.

The partner in charge of the audit resulting in this independent auditor's report is Gordon Bennie.

Ernst & Young

Partner's registration no.145
16 February 2018
Manama, Kingdom of Bahrain

Consolidated statement of financial position

	Note	**31.12.17**	31.12.16
		US$ millions	US$ millions
ASSETS			
Cash and other liquid assets	5	**3,768.5**	3,095.0
Securities purchased under agreements to resell	6	**855.0**	635.0
Placements	7	**6,033.2**	4,715.3
Trading securities	8	**191.8**	91.9
Investment securities	9	**3,993.8**	4,066.4
Loans and advances	10	**10,043.1**	9,745.1
Other assets	11	**585.9**	557.1
Total assets		**25,471.3**	22,905.8
LIABILITIES			
Deposits from banks	13	**2,129.1**	2,554.2
Deposits from customers	13	**15,989.8**	13,447.5
Securities sold under agreements to repurchase	14	**1,130.5**	1,321.5
Other liabilities	15	**547.4**	463.6
Senior term financing	16	**3,263.6**	2,761.6
Total liabilities		**23,060.4**	20,548.4
EQUITY			
Share capital	17	**2,500.0**	2,500.0
Reserves	18	**352.5**	364.7
Retained earnings		**(441.6)**	(507.3)
Total equity		**2,410.9**	2,357.4
Total liabilities & equity		**25,471.3**	22,905.8

The consolidated financial statements were approved by the Board of Directors on 16th February 2018 and signed on its behalf by:-

Abdullah bin Hassan Alabdulgader
Chairman

Yahya bin Abdullah Alyahya
Chairman of Board Audit Committee

Abdulaziz A. Al-Helaissi
Chief Executive Officer

The notes on pages 69 to 114 form part of these consolidated financial statements.

Consolidated statement of income

	Note	Year ended 31.12.17	Year ended 31.12.16
		US$ millions	US$ millions
Interest income	20	595.2	469.0
Interest expense	20	342.1	279.0
Net interest income		253.1	190.0
Fee and commission income	21	72.6	66.2
Foreign exchange income	22	14.1	14.4
Trading income	23	13.0	11.9
Other income	24	7.5	17.5
Total income		**360.3**	300.0
Staff expenses		142.6	136.9
Premises expenses		19.6	18.1
Other operating expenses		77.8	64.0
Total operating expenses		**240.0**	219.0
Net income before provisions and tax		**120.3**	81.0
Provision charge for investment securities	9	-	(1.3)
Provision charge for loans and advances	10	(43.7)	(38.6)
Net income before tax		**76.6**	41.1
Taxation charge		(6.6)	(3.8)
Net income		**70.0**	37.3

Abdullah bin Hassan Alabdulgader
Chairman

Yahya bin Abdullah Alyahya
Chairman of Board Audit Committee

Abdulaziz A. Al-Helaissi
Chief Executive Officer

The notes on pages 69 to 114 form part of these consolidated financial statements.

Consolidated statement of comprehensive income

	Year ended 31.12.17	Year ended 31.12.16
	US$ millions	US$ millions
Net income	**70.0**	37.3
Other comprehensive income:-		
Items that may subsequently be reclassified to consolidated statement of income:-		
Cash flow hedges:-		
- net changes in fair value	**(0.5)**	-
	(0.5)	-
Items that will not be reclassified to consolidated statement of income:-		
Net changes in fair value of equity investments classified as fair value through other comprehensive income (FVTOCI)	**(17.9)**	(14.9)
Remeasurement of defined benefit pension fund	**1.9**	(27.3)
	(16.0)	(42.2)
Total other comprehensive loss	**(16.5)**	(42.2)
Total comprehensive income / (loss)	**53.5**	(4.9)

The notes on pages 69 to 114 form part of these consolidated financial statements.

Consolidated statement of changes in equity

	Share capital	Reserves	Retained earnings	Total
	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2017	**2,500.0**	**364.7**	**(507.3)**	**2,357.4**
Net income for the year	**-**	**-**	**70.0**	**70.0**
Other comprehensive (loss) / income for the year	**-**	**(18.4)**	**1.9**	**(16.5)**
Total comprehensive (loss) / income for the year	**-**	**(18.4)**	**71.9**	**53.5**
Transfer from retained earnings	**-**	**7.6**	**(7.6)**	**-**
Transfer to retained earnings	**-**	**(1.4)**	**1.4**	**-**
At 31st December 2017	**2,500.0**	**352.5**	**(441.6)**	**2,410.9**
At 1st January 2016	2,500.0	379.8	(517.5)	2,362.3
Net income for the year	-	-	37.3	37.3
Other comprehensive loss for the year	-	(14.9)	(27.3)	(42.2)
Total comprehensive (loss) / income for the year	-	(14.9)	10.0	(4.9)
Transfer from retained earnings	-	2.6	(2.6)	-
Transfer to retained earnings	-	(2.8)	2.8	-
At 31st December 2016	2,500.0	364.7	(507.3)	2,357.4

The notes on pages 69 to 114 form part of these consolidated financial statements.

Consolidated statement of cash flows

	Note	Year ended 31.12.17	Year ended 31.12.16
		US$ millions	US$ millions
OPERATING ACTIVITIES			
Net income before tax		**76.6**	41.1
Adjustments to reconcile net income to net cash flow from operating activities:-			
Provision charge for investment securities		**-**	1.3
Provision charge for loans and advances		**43.7**	38.6
Tax paid		**(3.0)**	(2.0)
Realised losses / (profits) on debt investment securities		**0.4**	(1.3)
Amortisation of investment securities		**9.8**	12.1
Amortisation of senior term financing		**0.5**	-
Net (increase) / decrease in statutory deposits with central banks		**(44.5)**	20.8
Net (increase) / decrease in securities purchased under agreements to resell		**(220.0)**	1,200.0
Net increase in placements		**(1,317.9)**	(312.4)
Net increase in trading securities		**(99.9)**	(19.7)
Net increase in loans and advances		**(341.7)**	(622.3)
Increase in accrued interest receivable		**(47.6)**	(45.5)
Increase in accrued interest payable		**58.0**	42.3
Net decrease / (increase) in other net assets		**64.4**	(70.4)
Net (decrease) / increase in deposits from banks		**(425.1)**	568.3
Net increase / (decrease) in deposits from customers		**2,542.3**	(1,235.9)
Net decrease in securities sold under agreement to repurchase		**(191.0)**	(771.9)
Net cash inflow / (outflow) from operating activities		**105.0**	(1,156.9)
INVESTING ACTIVITIES			
Purchase of investment securities		**(1,370.0)**	(1,422.3)
Maturity of investment securities		**1,392.5**	1,193.7
Net cash inflow / (outflow) from investing activities		**22.5**	(228.6)
FINANCING ACTIVITIES			
Net increase in senior term financing		**501.5**	341.6
Net decrease in subordinated term financing		**-**	(150.0)
Net cash inflow from financing activities		**501.5**	191.6
Increase / (decrease) in cash and cash equivalents		**629.0**	(1,193.9)
Cash and cash equivalents at 1st January		**2,923.6**	4,117.5
Cash and cash equivalents at 31st December	5	**3,552.6**	2,923.6

The notes on pages 69 to 114 form part of these consolidated financial statements.

Notes to the consolidated financial statements

For the year ended 31st December 2017

1. Incorporation and registration

The parent company of 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 a conventional wholesale bank and a conventional retail bank with the Central Bank of Bahrain. The registered office of the Bank is located at Al-Dowali Building, 3 Palace Avenue, Manama, Kingdom of Bahrain.

The Bank and its subsidiaries (the Group), is principally engaged in the provision of wholesale commercial, asset management and investment banking services, with ambitions to enter a niche segment within retail consumer banking. The Group operates through subsidiaries, branch offices and representative offices located in five countries worldwide. The total number of staff at the end of the financial year was 1,127.

2. Accounting policies

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

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, equity investment securities, derivative financial instruments and pension liabilities 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 Group and are consistent with those of the previous year.

2.2 Consolidation principles

The consolidated financial statements include the accounts of Gulf International Bank B.S.C. and its subsidiaries. Subsidiaries are companies and other entities, including special purpose entities, which the Bank controls. The Bank controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The subsidiary's accounts are derecognised from the consolidated financial statements from the point when the control ceases. All intercompany balances and transactions, including unrealised gains and losses on transactions between Group companies, have been eliminated.

2.3 Foreign currencies

The consolidated financial statements are presented in US Dollars, representing the Group's functional and presentation currency. Transactions in foreign currencies are converted to US Dollars at the spot 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.

2.4 Financial assets and liabilities

Financial assets and liabilities comprise all assets and liabilities reflected in the statement of financial position, although excluding employee benefit plans and property and equipment.

a) Recognition and measurement

The Group recognises financial assets and liabilities in the consolidated statement of financial position when, and only when, the Group becomes party to the contractual provisions of the instrument.

Financial instruments are classified at inception into one of the following categories, which then determine the subsequent measurement methodology:-

Financial assets are classified into one of the following three categories:-

- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income (FVTOCI); or
- financial assets at fair value through the profit or loss (FVTPL).

Financial liabilities are classified into one of the following two categories:-

- financial liabilities at amortised cost; or
- financial liabilities at fair value through the profit or loss (FVTPL).

Financial assets are initially recognised at fair value. Financial liabilities are initially recognised at fair value, representing the proceeds received net of premiums, discounts and transaction costs that are directly attributable to the financial liability.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.4 Financial assets and liabilities (continued)

a) Recognition and measurement (continued)

All regular way purchases and sales of financial assets and liabilities classified as FVTPL are recognised on the trade date, i.e. the date on which the Group commits to purchase or sell the financial asset or liability. All regular way purchases and sales of other financial assets and liabilities are recognised on the settlement date, i.e. the date on which the asset or liability is received from or delivered to 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.

Subsequent to initial measurement, financial assets and liabilities are measured at either amortised cost or fair value. The classification and the basis for measurement are subject to the Group's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, as detailed below:-

Financial assets at amortised cost

Financial assets are measured at amortised cost using the effective interest rate method if:-

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

If either of these two criteria is not met, the financial assets are classified and measured at fair value through the profit or loss (FVTPL).

Additionally, even if a financial asset meets the amortised cost criteria, the Group may choose to designate the financial asset at FVTPL. Such an election is irrevocable and applicable only if the FVTPL classification significantly reduces a measurement or recognition inconsistency.

Financial assets at fair value through other comprehensive income (FVTOCI)

At initial recognition, the Group can make an irrevocable election to classify an equity investment that is not held for trading as FVTOCI.

For this purpose, a financial asset is deemed to be held for trading if the equity investment meets any of the following conditions:-

- it has been acquired principally for the purpose of selling in the near term;
- on initial recognition, it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profitability; or
- it is a derivative and not designated and effective as a hedging instrument or a financial guarantee.

The irrevocable election is on an instrument-by-instrument basis. If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the consolidated statement of income.

Financial assets at fair value through the profit or loss (FVTPL)

Financial assets not otherwise classified above are classified and measured as FVTPL.

Financial liabilities at amortised cost

All financial liabilities, other than those classified as financial liabilities at FVTPL, are classified as financial liabilities at amortised cost and are measured at amortised cost using the effective interest rate method as described in note 2.7(a).

Financial liabilities at fair value through the profit or loss

Financial liabilities not otherwise classified above are classified as financial liabilities at FVTPL. This classification includes derivatives that are liabilities measured at fair value.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.4 Financial assets and liabilities (continued)

b) Modification of assets and liabilities

Financial assets

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, the original financial asset is derecognised and a new financial asset is recognised at either amortised cost or fair value. If the cash flows are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Group recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income.

Financial liabilities

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

2.5 Impairment of financial assets

Impairment allowances for expected credit losses (ECL) are recognised for financial instruments that are not measured at FVTPL. No impairment loss is recognised on equity investments.

An ECL provision is made at an amount equal to the lifetime ECL, except for the following, for which they are measured as a 12-month ECL:-

- debt investment securities that are determined to have a low credit risk (equivalent to investment grade rating) at the reporting date; and
- other financial instruments for which the credit risk has not increased significantly since their initial recognition.

The Group classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:-

- Stage 1: for financial instruments where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the Group recognises an allowance based on the 12-month ECL.
- Stage 2: for financial instruments where there has been a significant increase in credit risk since initial recognition but that are not credit-impaired, the Group recognises an allowance for the lifetime ECL.
- Stage 3: for credit-impaired financial instruments, the Group recognises the lifetime ECL.

12-month ECL (stage 1) is the portion of ECL that results from probable default events on a financial instrument within 12 months after the reporting date.

Lifetime ECL (stage 2) is a probability-weighted estimate of credit losses and is determined based on the difference between the present value of all cash shortfalls. The cash shortfall is the difference between all contractual cash flows that are due to the Group and the present value of the recoverable amount, for financial assets that are not credit-impaired at the reporting date.

For stage 3 financial instruments, the provisions for credit-impairment are 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, at the current market rate of interest for a similar financial asset.

Provisions for credit-impairment are recognised in the consolidated statement of income and are reflected in an allowance account against loans and advances, investment securities, and placements.

Financial assets are written off after all restructuring and collection activities have taken place and there is no realistic prospect of recovery. Subsequent recoveries are included in other income.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

2. Accounting policies (continued)

2.5 Impairment of financial assets (continued)

Financial assets that are measured at amortised cost are tested as to whether they are credit-impaired. Objective evidence that a financial asset is credit-impaired may include a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Financial assets which have been renegotiated or modified are no longer considered to be past due and are replaced on performing status when all principal and interest payments are up to date and future payments are reasonably assured. Financial assets subject to individual impairment assessment and whose terms have been renegotiated, are subject to on-going review to determine whether they remain impaired or should be considered past due. All renegotiated or modified facilities are classified as stage 2 or stage 3 for a minimum period of 12 months from the date of renegotiation. The ECL on renegotiated financial instruments is measured based on whether the terms of renegotiation resulted in the derecognition of an existing asset.

2.6 Offsetting financial assets and liabilities

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

2.7 Revenue recognition

a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial assets and liabilities except those classified as FVTPL are recognised using the effective interest rate method. The effective interest rate method is a method of calculating the amortised cost of a financial asset or liability and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows through the expected life of the financial asset or liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or liability. The application of the effective interest rate method has the effect of recognising interest income and interest expense evenly in proportion to the amount outstanding over the period to maturity or repayment.

In calculating the effective interest rate, cash flows are estimated taking into consideration all contractual terms of the financial asset or liability but excluding future credit losses. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate.

Interest income is suspended when either 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.

b) Fees and commissions

Fees and commissions that are integral to the effective interest rate of a financial asset or liability are included in the calculation of the effective interest rate.

Other fees and commissions are recognised as the related services are performed or received, and are included in fee and commission income.

c) Trading and foreign exchange income

Trading and foreign exchange income arise from earnings generated from customer business and market making, and from changes in fair value resulting from movements in interest and exchange rates, equity prices and other market variables. Changes in fair value and gains and losses arising on the purchase and sale of trading instruments are included in trading income, together with the related interest income, interest expense and dividend income.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.7 Revenue recognition (continued)

d) Dividend income

Dividend income is recognised as follows:-

- dividends from equity instruments classified as FVTPL are recognised when the right to receive the dividend is established and are included in trading income.
- dividends from equity instruments classified as FVTOCI are recognised when the right to receive the dividend is established and are included in other income.

2.8 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 statement of financial position 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.

2.9 Premises and equipment

Land is stated at cost. Other premises and equipment are stated at cost less accumulated depreciation. The residual values and useful lives of premises and equipment are reviewed at each balance sheet date, and adjusted where appropriate. Depreciation is calculated using the straight-line method over various periods. Where the carrying amount of premises or equipment is greater than the 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.

2.10 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.

2.11 Derivative financial instruments and hedge accounting

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 credit markets.

Derivative financial instruments are recognised in the consolidated statement of financial position at fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate.

In the consolidated statement of financial position, 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 trading income.

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, including how the Group will address the hedge ratio,
- the effectiveness of the hedge must be capable of being reliably measured, and
- there is an economic relationship between the hedging instrument and the hedged item and the effect of credit risk does not dominate the fair value changes of that relationship.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.11 Derivative financial instruments and hedge accounting (continued)

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 trading 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 statement of financial position. 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 other comprehensive income. Unrealised gains or losses recognised in other comprehensive income 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 consolidated statement of income 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 included in trading income.

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

Hedge accounting is discontinued when the derivative hedging instrument either expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. Gains and losses arising on the termination of derivatives designated as cash flow hedges are recognised in interest income or interest expense over the original tenor of the terminated hedge transaction.

Some hybrid instruments contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. Embedded derivatives are separated from the host contract and accounted for separately if certain criteria are met. Where it is not practically possible to separate the embedded derivative, the entire hybrid instrument is categorised as a financial asset at FVTPL and measured at fair value. Changes in fair value are included in trading income.

2.12 Financial guarantees

Financial guarantees are contracts that require the Group to make specified payments to reimburse the holder for a loss it incurs because a specific debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantees are issued to financial institutions and other counterparties on behalf of customers to secure loans, overdrafts and other banking facilities, and to other parties in relation to the performance of customers under obligations related to contracts, advance payments made by other parties, tenders and retentions.

Financial guarantees are initially recognised at fair value on the date the guarantee is issued. The guarantee liability is subsequently measured at the higher of the initial measurement, less amortisation to recognise the fee income earned over the period, or the present value of any expected payments to settle the liability when a payment under the contract has become probable. The expected loss on financial guarantees is measured at the expected payment to reimburse the holder less any amounts that the Group expects to recover. Any increase in a liability relating to guarantees is recognised in the consolidated statement of income. In the consolidated statement of financial position, financial guarantees are included in other liabilities.

2.13 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, insurance plans or are directly funded by the Group. The Group also pays contributions to government managed pension plans in accordance with the legal requirements in each location.

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

The calculation of obligations in respect of the defined benefit pension plans are performed by qualified actuaries using the projected unit credit method. The Group's net obligation is calculated by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of the plan assets. When the calculation results in a potential asset for the Group, the recognised asset is limited to a ceiling so that it does not exceed the economic benefits available in the form of refunds from the plans or reductions in future contributions.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.13 Post retirement benefits (continued)

Remeasurements of the net defined benefit liability or asset, which comprise actuarial gains and losses, the return of plan assets (excluding interest) and the effect of the asset ceiling, are recognised immediately in the consolidated statement of other comprehensive income. The Group determines the net interest expense or income on the net defined benefit liability or asset for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the year to the opening net defined benefit liability or asset. Net interest expense and other expenses related to the defined benefit plans are recognised in the consolidated statement of income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in the consolidated statement of income. The Group recognises gains and losses on the settlement of defined benefit plans when the settlement occurs.

2.14 Taxation

a) Current tax

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

b) Deferred tax

Deferred tax is provided, using the liability method, for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. A deferred tax asset is recognised only to the extent that it is probable that future taxable income will be available against which the unutilised tax losses and credits can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax assets and liabilities are offset only if certain criteria are met. Currently enacted tax rates are used to determine deferred taxes.

2.15 Cash and cash equivalents

In the consolidated statement of cash flows, cash and cash equivalents comprise cash and other liquid assets, excluding statutory deposits with central banks.

2.16 Segment reporting

An operating segment is a distinguishable component of the Group that is engaged in business activities from which revenues are earned and expenses are incurred, including revenues and expenses that relate to transactions with any of the Group's other operating segments. All segments have discrete financial information which is regularly reviewed by the Group's Management Committee, being the Group's chief operating decision maker, to make decisions about resources allocated to the segment and to assess its performance. The Group's Management Committee assesses the segments based on net interest income which accounts for the majority of the Group's revenues.

2.17 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 fee and commission income.

2.18 Dividends

Dividends on issued shares are recognised as a liability and deducted from equity when they are approved by the Bank's shareholders.

2.19 Shariah-compliant banking

The Group offers various Shariah-compliant products to its customers. The Shariah-compliant activities are conducted in accordance with Shariah principles and are subject to the supervision and approval of the Group's Shariah Supervisory Board. The disclosures set out in the consolidated financial statements in relation to these activities are prepared in accordance with Financial Accounting Standard 18 issued by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI).

2.20 Comparatives

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

2. Accounting policies (continued)

2.21 Future accounting developments

The International Accounting Standards Board (IASB) have issued a number of new standards, amendments to standards, and interpretations that are not yet effective and have not been applied in the preparation of the consolidated financial statements for the year ended 31st December 2017. The relevant new standards, amendments to standards, and interpretations, are as follows:-

- IFRS 15 – Revenue from contracts with customers:-
  IFRS 15 introduces a new five-step model framework for determining whether, how much and when revenue is recognised. IFRS 15 is effective for annual periods beginning on or after 1st January 2018. There will be no material impact on the Group's consolidated financial statements resulting from the application of this standard.

- IFRS 16 – Leases:-
  IFRS 16 requires lessees to recognise most leases on their balance sheets as lease liabilities, with the corresponding right of use assets. IFRS 16 is effective for annual periods beginning on or after 1st January 2019. Early application is permitted provided the new revenue standard, IFRS 15, is applied on the same date. Lessees must adopt IFRS 16 using either a full retrospective or a modified retrospective approach. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of this standard.

2.22 Capital management

The Group uses regulatory capital ratios and its economic capital framework to monitor its capital base. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans.

3. Accounting estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of certain financial assets, liabilities, income and expenses.

The use of estimates and assumptions is principally limited to the determination of provisions for impairment, the valuation of financial instruments, the valuation of the Group's defined benefit pension plans, and in determining control relationships over investees, as explained in more detail below:-

3.1 Provisions for impairment

Financial assets are evaluated for impairment on the basis set out in note 2.5.

In determining impairment of financial assets, judgement is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether the credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL. The information about the judgements made are set out in note 26.1.

3.2 Fair value of financial assets and liabilities

Where the fair value of financial assets and liabilities cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is derived from observable markets where available, but where this is not feasible, a degree of judgement is required in determining assumptions used in the models. Changes in assumptions used in the models could affect the reported fair value of financial assets and liabilities.

3.3 Retirement benefit obligations

Management, in coordination with independent qualified actuaries, are required to make assumptions regarding the defined benefit pension plans. The principal actuarial assumptions for the defined benefit pension plans are set out in note 12 and include assumptions on the discount rate, return on pension plan assets, mortality, future salary increases, and inflation. Changes in the assumptions could affect the reported asset, service cost and return on pension plan assets.

3.4 Determination of control over investees

The Group acts as fund manager to a number of investment funds. The determination of whether the Group controls an investment fund is based on an assessment of the aggregate economic interests of the Group in the fund and includes an assessment of any carried interests, expected management fees, and the investors' rights to remove the Group as fund manager.

Management are required to conclude whether the Group acts as an agent for the investors in the fund, or if the underlying fund is controlled by the Group.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

4. Classification of assets and liabilities

The classification of assets and liabilities by accounting categorisation was as follows:-

	Financial assets at amortised cost	Financial assets & liabilities at FVTPL	Financial assets at FVTOCI	Financial liabilities at amortised cost	Non-financial assets & liabilities	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2017						
Cash and other liquid assets	**3,768.5**	-	-	-	-	**3,768.5**
Securities purchased under agreements to resell	**855.0**	-	-	-	-	**855.0**
Placements	**6,033.2**	-	-	-	-	**6,033.2**
Trading securities	-	**191.8**	-	-	-	**191.8**
Investment securities	**3,823.1**	-	**170.7**	-	-	**3,993.8**
Loans and advances	**10,043.1**	-	-	-	-	**10,043.1**
Other assets	**244.7**	**182.2**	-	-	**159.0**	**585.9**
Total assets	**24,767.6**	**374.0**	**170.7**	-	**159.0**	**25,471.3**
Deposits from banks	-	-	-	**2,129.1**	-	**2,129.1**
Deposits from customers	-	-	-	**15,989.8**	-	**15,989.8**
Securities sold under agreements to repurchase	-	-	-	**1,130.5**	-	**1,130.5**
Other liabilities	-	**131.5**	-	**333.0**	**82.9**	**547.4**
Senior term financing	-	-	-	**3,263.6**	-	**3,263.6**
Equity	-	-	-	-	**2,410.9**	**2,410.9**
Total liabilities & equity	-	**131.5**	-	**22,846.0**	**2,493.8**	**25,471.3**
At 31st December 2016						
Cash and other liquid assets	3,095.0	-	-	-	-	3,095.0
Securities purchased under agreements to resell	635.0	-	-	-	-	635.0
Placements	4,715.3	-	-	-	-	4,715.3
Trading securities	-	91.9	-	-	-	91.9
Investment securities	3,815.3	-	251.1	-	-	4,066.4
Loans and advances	9,745.1	-	-	-	-	9,745.1
Other assets	228.5	168.9	-	-	159.7	557.1
Total assets	22,234.2	260.8	251.1	-	159.7	22,905.8
Deposits from banks	-	-	-	2,554.2	-	2,554.2
Deposits from customers	-	-	-	13,447.5	-	13,447.5
Securities sold under agreements to repurchase	-	-	-	1,321.5	-	1,321.5
Other liabilities	-	132.2	-	246.1	85.3	463.6
Senior term financing	-	-	-	2,761.6	-	2,761.6
Subordinated term financing	-	-	-	-	-	-
Equity	-	-	-	-	2,357.4	2,357.4
Total liabilities & equity	-	132.2	-	20,330.9	2,442.7	22,905.8

The other assets and other liabilities classified as financial assets and liabilities at FVTPL comprise the fair values of derivatives designated as fair value and cash flow hedges.

The fair value analysis of derivative financial instruments is set out in note 30.4.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

5. Cash and other liquid assets

	31.12.17	31.12.16
	US$ millions	US$ millions
Cash and balances with central banks	**2,862.7**	2,311.7
Cash and balances with banks	**587.5**	405.0
Government bills	**102.4**	206.9
Cash and cash equivalents	**3,552.6**	2,923.6
Statutory deposits with central banks	**215.9**	171.4
Cash and other liquid assets	**3,768.5**	3,095.0

Statutory deposits with central banks are subject to local regulations which provide for restrictions on the deployment of these funds.

6. Securities purchased under agreements to resell

The Group enters into collateralised lending transactions (reverse repurchase agreements) in the ordinary course of its operating activities. The collateral is in the form of highly rated debt securities. The collateralised lending transactions are conducted under standardised terms that are usual and customary for such transactions.

7. Placements

Placements at 31st December 2017 included placements with central banks amounting to US$1,749.1 million (2016: US$1,212.7 million). The placements with central banks represented the placement of surplus liquid funds.

8. Trading securities

	31.12.17	31.12.16
	US$ millions	US$ millions
Managed funds	**166.6**	66.6
Debt securities	**13.0**	13.1
Equity securities	**12.2**	12.2
	191.8	91.9

Managed funds comprised funds placed for investment with specialist managers. The increase in managed funds during the year ended 31st December 2017 was principally attributable to seed investments in new funds managed by the Group.

Debt and equity securities comprised securities acquired in relation to investment banking activities undertaken by the Group. The securities were held with the intention of selling in the near term.

9. Investment securities

9.1 Composition

The credit rating profile of investment securities, based on the lowest rating assigned by the major international rating agencies, was as follows:-

		31.12.17		31.12.16
	US$ millions	%	US$ millions	%
AAA to A- / Aaa to A3	**3,326.7**	**87.0**	3,292.1	86.3
BBB+ to BBB- / Baa1 to Baa3	**267.1**	**7.0**	310.9	8.1
BB+ to BB- / Ba1 to Ba3	**229.3**	**6.0**	212.3	5.6
Total debt securities	**3,823.1**	**100.0**	3,815.3	100.0
Equity investments	**170.7**		251.1	
	3,993.8		4,066.4	

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

9. Investment securities (continued)

9.1 Composition (continued)

Investment securities principally comprised investment-grade rated debt securities issued by major international financial institutions and government-related entities.

Investment securities rated BB+ to BB- / Ba1 to Ba3 at 31st December 2017 and 31st December 2016 principally comprised GCC sovereign debt securities.

Debt securities are classified as investment securities at amortised cost and equity investments are classified as FVTOCI.

The decrease in equity investments during the year ended 31st December 2017 was principally due to the sale of equity holdings during the year. The sales generated a net realised gain of US$0.7 million. The net realised gain was transferred from the investment securities revaluation reserve to retained earnings during the year ended 31st December 2017.

9.2 Provisions for impairment

The movements in the provisions for credit impairment of investment securities were as follows:-

	Collective provisions		**Specific provisions**	**2017**	Collective provisions		Specific provisions	2016
	Stage 1	**Stage 2**	**Stage 3**	**Total**	Stage 1	Stage 2	Stage 3	Total
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January	**4.5**	**-**	**-**	**4.5**	3.2	-	-	3.2
Net remeasurement of loss allowance	**-**	**-**	**-**	**-**	1.3	-	-	1.3
At 31st December	**4.5**	**-**	**-**	**4.5**	4.5	-	-	4.5

Stage 1 provisions under IFRS 9 reflect the probability-weighted estimate of expected credit losses, and comprise both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and including forward-looking information.

10. Loans and advances

10.1 Composition

	31.12.17	31.12.16
	US$ millions	US$ millions
Gross loans and advances	**10,456.7**	10,166.1
Provisions for impairment	**(413.6)**	(421.0)
Net loans and advances	**10,043.1**	9,745.1

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

10. Loans and advances (continued)

10.2 Industrial classification

	31.12.17	31.12.16
	US$ millions	US$ millions
Trading and services	**2,294.9**	2,208.2
Financial	**2,080.2**	1,958.6
Energy, oil and petrochemical	**1,737.3**	2,044.8
Transportation	**1,371.7**	1,278.1
Manufacturing	**1,159.0**	1,100.6
Construction	**747.4**	728.3
Real estate	**312.1**	188.7
Agriculture and mining	**237.5**	223.8
Communication	**235.0**	183.0
Government	**113.0**	113.4
Other	**168.6**	138.6
	10,456.7	10,166.1
Provisions for impairment	**(413.6)**	(421.0)
	10,043.1	9,745.1

Gross loans at 31st December 2017 included Shariah-compliant transactions amounting to US$3,658.7 million (2016: US$3,591.9 million).

10.3 Provisions for impairment

	Collective provisions		**Specific provisions**	**2017**	Collective provisions		Specific provisions	2016
	Stage 1	**Stage 2**	**Stage 3**	**Total**	Stage 1	Stage 2	Stage 3	Total
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January	**82.5**	**83.0**	**255.5**	**421.0**	76.2	127.0	226.5	429.7
Transfer to stage 1	**2.7**	**(2.7)**	**-**	**-**	11.1	(0.4)	(10.7)	-
Transfer to stage 2	**(13.9)**	**13.9**	**-**	**-**	(4.2)	4.2	-	-
Transfer to stage 3	**(1.1)**	**(2.9)**	**4.0**	**-**	(0.2)	(47.5)	47.7	-
Amounts utilised	**-**	**-**	**(51.2)**	**(51.2)**	-	-	(46.0)	(46.0)
Exchange rate movements	**-**	**-**	**0.1**	**0.1**	-	-	(1.3)	(1.3)
Net remeasurement of loss allowance	**(23.9)**	**15.0**	**52.6**	**43.7**	(0.4)	(0.3)	39.3	38.6
At 31st December	**46.3**	**106.3**	**261.0**	**413.6**	82.5	83.0	255.5	421.0

The stage 1 and stage 2 provisions reflect the probability-weighted estimate of expected credit losses under IFRS 9. The provisions comprise both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and includes forward-looking information.

Stage 3 provisions reflect credit-impaired provisions based on the difference between the net carrying amount and the recoverable amount of the loan.

The gross amount of stage 3 loans against which a stage 3 provision had been made at 31st December 2017 was US$379.8 million (2016: US$367.2 million). Total stage 3 provisions at 31st December 2017 represented 68.7 per cent of loans against which a stage 3 provision had been made (2016: 69.6 per cent).

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

10. Loans and advances (continued)

10.3 Provisions for impairment (continued)

Amounts utilised during the years ended 31st December 2017 and 31st December 2016 mainly represented provisions utilised on the transfer of the related loans to the memorandum records. Recovery efforts on these loans are still ongoing with the intention to maximise potential recoveries.

Total provisions at 31st December 2017 included US$19.1 million of provisions in relation to credit-related contingent exposures (2016: US$18.7 million).

10.4 Past due loans

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

	Gross	**31.12.17 Carrying Amount**	Gross	31.12.16 Carrying Amount
	US$ millions	**US$ millions**	US$ millions	US$ millions
Corporates	**454.2**	**198.6**	328.6	84.2
Financial sector	**25.2**	**20.2**	10.7	9.8
	479.4	**218.8**	339.3	94.0

Corporates include loans extended for investment purposes.

At 31st December 2017, total specific provisions against past due loans represented 54.4 per cent of gross past due loans (2016: 72.3 per cent).

10.5 Restructured and modified loans

During the years ended 31st December 2017 and 31st December 2016, the Group modified the contractual terms of a number of facilities for commercial purposes. Such modifications did not result in the derecognition of any assets, and the resulting modification gains were immaterial to the Group's consolidated statement of income. The nature of modifications is set out in note 26.1.

During the year ended 31st December 2017, the Group restructured one loan amounting to US$143.5 million, which resulted in concessions that would not ordinarily have been accepted due to a deterioration in the customer's financial position (2016: nil).

10.6 Collateral

The Group did not take possession of any collateral during the years ended 31st December 2017 and 31st December 2016.

11. Other assets

	31.12.17	31.12.16
	US$ millions	US$ millions
Accrued interest, fees and commissions	**214.7**	167.1
Derivative financial instruments	**182.2**	168.9
Premises and equipment	**111.6**	122.3
Prepayments	**27.3**	29.0
Deferred items	**20.1**	8.4
Other, including accounts receivable	**30.0**	61.4
	585.9	557.1

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 30.4.

The increase in accrued interest, fees and commissions at 31st December 2017 was principally due to an increase in the volume of interest-bearing financial assets.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

12. Post retirement benefits

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

The Bank maintains 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 benefit and defined contribution pension plans for the year ended 31st December 2017 amounted to US$13.8 million (2016: US$13.5 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a funded defined benefit final salary pension plan for a number of its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The fund is subject to the UK regulatory framework for pensions.

The fund exposes the Group to the risk of paying unanticipated contributions in times of adverse experience. Such events could be members living for longer than expected, higher than expected inflation or salary growth, and the risk that increases in the fund's obligations are not met by a corresponding improvement in the value of the fund's assets.

12.1 The amount recognised in the consolidated statement of financial position is analysed as follows:-

	31.12.17	31.12.16
	US$ millions	US$ millions
Fair value of plan assets	181.8	190.1
Present value of fund obligations	193.6	203.9
Net liability in the consolidated statement of financial position	**(11.8)**	(13.8)

The net liability or asset is a valuation measure derived using an actuarial mathematical model. The modelling is performed by an independent actuary based upon the measurement criteria stipulated by the accounting standard IAS19 - Employee Benefits. A pension asset does not indicate a realisable receivable from the pension plan and a liability does not indicate a funding requirement to the pension plan in the short term.

The valuation measure indicates a point in time view of the fair value of the plan's assets less a discounted measure of the plan's future obligations over a duration of 19 years.

12.2 The movements in the fair value of plan assets were as follows:-

	2017	2016
	US$ millions	US$ millions
At 1st January	190.1	203.8
Included in the consolidated statement of income:-		
- Interest income on the plan assets	4.8	6.6
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements:-		
- Return on plan assets excluding interest income	6.7	15.2
Other movements:-		
- Exchange rate movements	(10.0)	(30.2)
- Contributions paid by the Group	0.5	0.6
- Benefits paid by the plan	(10.3)	(5.9)
At 31st December	**181.8**	190.1

The plan assets at 31st December 2017 comprised a 37 per cent (2016: 42 per cent) exposure to multi-asset funds, with the balance of the exposure to equities, debt and hedging funds. The plan assets have a quoted price in an active market and the hedging funds are designed to hedge the majority of inflation and interest rate risk.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

12. Post retirement benefits (continued)

12.3 The movements in the present value of fund obligations were as follows:-

	2017	2016
	US$ millions	US$ millions
At 1st January	**203.9**	190.8
Included in the consolidated statement of income:-		
- Current service cost	**0.6**	0.7
- Interest cost on the fund obligations	**5.2**	6.1
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Financial assumptions	**6.5**	43.2
- Demographic assumptions	**(3.6)**	(2.3)
- Experience	**1.9**	(0.3)
Other movements:-		
- Exchange rate movements	**(10.6)**	(28.4)
- Benefits paid by the plan	**(10.3)**	(5.9)
At 31st December	**193.6**	203.9

12.4 The movements in the net (liability) / asset recognised in the consolidated statement of financial position were as follows:-

	2017	2016
	US$ millions	US$ millions
At 1st January	**(13.8)**	13.0
Net expense included in consolidated statement of income	**(1.0)**	(0.2)
Remeasurement included in consolidated statement of comprehensive income	**1.9**	(27.3)
Contributions paid by the Group	**0.5**	0.7
Exchange rate movements	**0.6**	-
At 31st December	**(11.8)**	(13.8)

The Group paid US$0.5 million in contributions to the plan during 2017 and expects to pay US$0.5 million during 2018.

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

	2017	2016
Discount rate (per cent)	**2.5**	2.8
Retail price inflation (per cent)	**3.2**	3.3
Consumer price inflation (per cent)	**2.2**	2.3
Pension increase rate (per cent)	**3.1**	3.2
Salary growth rate (per cent)	**3.0**	3.0
Average life expectancy (years)	**89**	89

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

12. Post retirement benefits (continued)

12.6 Sensitivity information
The present value of the fund's obligations, which has a weighted average duration of 19 years, was calculated based on certain actuarial assumptions. Should any one of the key assumptions change by an amount that is probable whilst holding the other assumptions constant, the present value of the fund's obligations would decrease as follows:-

	2017	2016
	US$ millions	US$ millions
Life expectancy increased by 1 year	**0.2**	0.2
Discount rate decreased by 0.5 per cent	**0.2**	0.2
Inflation increased by 0.5 per cent	**0.2**	0.2

13. Deposits
The geographical composition of total deposits was as follows:-

	31.12.17	31.12.16
	US$ millions	US$ millions
GCC countries	**12,600.2**	10,387.7
Other Middle East and North Africa countries	**779.3**	1,102.6
Other countries	**4,739.4**	4,511.4
	18,118.9	16,001.7

GCC deposits comprise deposits from the Gulf Cooperation Council (GCC) country governments and central banks and other institutions headquartered in the GCC states.

At 31st December 2017, GCC deposits represented 69.5 per cent of total deposits (2016: 64.9 per cent).

Total deposits at 31st December 2017 included Shariah-compliant transactions amounting to US$4,244.5 million (2016: US$3,265.4 million). Shariah-compliant transactions comprise murabaha contracts. The increase in Shariah-compliant transactions at 31st December 2017 was principally due to an increase in retail banking-related murabaha deposits.

14. 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 investment securities portfolio. At 31st December 2017, the fair value of investment securities that had been pledged as collateral under repurchase agreements was US$1,183.8 million (2016: US$1,360.0 million). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

15. Other liabilities

	31.12.17	31.12.16
	US$ millions	US$ millions
Accrued interest	**196.1**	138.1
Derivative financial instruments	**131.5**	132.2
Deferred items	**82.9**	85.3
Pension liability	**11.8**	13.8
Other, including accounts payable and accrued expenses	**125.1**	94.2
	547.4	463.6

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

15. 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 30.4.

Deferred items represent amounts received, e.g. loan origination fees, that are being amortised to income over the period of the related financial asset.

An analysis of the pension liability is set out in note 12.

16. Senior term financing

	Maturity	31.12.17	31.12.16
		US$ millions	US$ millions
Floating rate loans	2018	691.7	673.9
Floating rate note	2019	533.3	533.1
Floating rate loans	2019 - 2022	800.0	521.6
Floating rate note	2021	533.3	533.1
Floating rate note	2022	497.7	-
Floating rate repurchase agreements	2022 - 2026	207.6	-
Floating rate loan	2017	-	499.9
		3,263.6	2,761.6

17. Share capital

The authorised share capital at 31st December 2017 comprised 3.0 billion shares of US$1 each (2016: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2017 comprised 2.5 billion shares of US$1 each (2016: 2.5 billion shares of US$1 each). All issued shares are fully paid.

18. Reserves

	Share premium	Compulsory reserve	Voluntary reserve	Cash flow hedge reserve	Investment securities revaluation reserve	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2017	**7.6**	**222.0**	**159.5**	**-**	**(24.4)**	**364.7**
Net fair value losses on cash flow hedges	-	-	-	(0.5)	-	(0.5)
Net fair value losses on equity investments classified as FVTOCI	-	-	-	-	(17.9)	(17.9)
Transfers to retained earnings	-	-	-	-	(1.4)	(1.4)
Net decrease	-	-	-	(0.5)	(19.3)	(19.8)
Transfers from retained earnings	-	3.8	3.8	-	-	7.6
At 31st December 2017	**7.6**	**225.8**	**163.3**	**(0.5)**	**(43.7)**	**352.5**
At 1st January 2016	7.6	220.7	158.2	-	(6.7)	379.8
Net fair value losses on equity investments classified as FVTOCI	-	-	-	-	(14.9)	(14.9)
Transfers to retained earnings	-	-	-	-	(2.8)	(2.8)
Net decrease	-	-	-	-	(17.7)	(17.7)
Transfers from retained earnings	-	1.3	1.3	-	-	2.6
At 31st December 2016	7.6	222.0	159.5	-	(24.4)	364.7

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

18. Reserves (continued)

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 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. The compulsory reserve may be utilised as per the terms of the Bank's articles of association.

19. Dividends

No dividend is proposed in respect of the financial years ended 31st December 2017 and 31st December 2016.

20. Net interest income

	Year ended 31.12.17	Year ended 31.12.16
	US$ millions	US$ millions
Interest income		
Placements and other liquid assets	**113.6**	57.0
Investment securities	**86.3**	70.6
Loans and advances	**395.3**	341.4
Total interest income	**595.2**	469.0
Interest expense		
Deposits from banks and customers	**235.3**	196.0
Securities sold under agreements to repurchase	**10.9**	14.5
Term financing	**95.9**	68.5
Total interest expense	**342.1**	279.0
Net interest income	**253.1**	190.0

Interest income on loans and advances includes loan origination fees that form an integral part of the effective interest rate of the loan.

The increases in interest income on placements and other liquid assets, and interest expense on deposits from banks and customers was principally due to an increase in deposits from customers during the year ended 31st December 2017 reflecting a higher level of deposit activity by the Group's London-based subsidiary, Gulf International Bank (UK) Limited. This also accounted for an increase in cash and other liquid assets. The increases in the average volume of cash and other liquid assets, and deposits from customers is set out in note 39.

Accrued interest on impaired and past due loans included in interest income for the year ended 31st December 2017 amounted to nil (2016: nil). There was no accrued but uncollected interest included in interest income on past due loans or past due investment securities for either the year ended 31st December 2017 or 31st December 2016.

21. Fee and commission income

	Year ended 31.12.17	Year ended 31.12.16
	US$ millions	US$ millions
Fee and commission income		
Investment banking and management fees	**34.4**	29.8
Commissions on letters of credit and guarantee	**33.6**	31.2
Loan commitment fees	**3.2**	3.1
Loan agency fees	**1.3**	1.0
Other fee and commission income	**1.8**	2.4
Total fee and commission income	**74.3**	67.5
Fee and commission expense	**(1.7)**	(1.3)
Net fee and commission income	**72.6**	66.2

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

21. Fee and commission income (continued)

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, initial public offerings, and mergers and acquisitions.

Investment banking and management fees for the year ended 31st December 2017 included fee income relating to the Group's fiduciary activities amounting to US$26.8 million (2016: US$23.2 million).

Fee and commission expense principally comprises security custody fees and bank charges and commissions.

22. Foreign exchange income

Foreign exchange income principally comprises customer-initiated foreign exchange contracts which have been offset in the market with matching contracts. There is no remaining market risk associated with these offset customer-related foreign exchange contracts.

Foreign exchange includes spot and forward foreign exchange contracts, and currency futures and options.

23. Trading income

	Year ended 31.12.17	Year ended 31.12.16
	US$ millions	US$ millions
Interest rate derivatives	**6.6**	8.8
Managed funds	**6.0**	2.1
Commodity options	**0.1**	0.2
Debt securities	**0.3**	0.1
Equity securities	**-**	0.7
	13.0	11.9

Trading income comprises gains and losses arising both on the purchase and sale, and from changes in the fair value, of trading instruments, together with the related interest income, interest expense and dividend income. Trading income accordingly incorporates all income and expenses related to the Group's trading activities.

Interest rate derivative income principally comprises customer-initiated contracts which have been offset in the market with matching contracts. There is no remaining market risk associated with these contracts.

The increase in trading income derived from managed funds during the year ended 31st December 2017 was attributable to a high level of investment as referred to in note 8.

24. Other income

	Year ended 31.12.17	Year ended 31.12.16
	US$ millions	US$ millions
Dividends on equity investments classified as FVTOCI	**6.9**	7.3
Recoveries on previously written off assets	**1.8**	8.8
Net realised (losses) / profits on investment debt securities	**(0.4)**	1.3
Realised loss on written off asset	**(1.0)**	-
Sundry income	**0.2**	0.1
	7.5	17.5

Recoveries on previously written off assets comprise recoveries on assets that had previously been either written off or transferred to the memorandum records.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

24. Other income (continued)

Net realised losses on investment debt securities for the year ended 31st December 2017 principally related to the sale of securities due to credit concerns.

The realised loss on written off asset for the year ended 31st December 2017 related to a contractual conditional partial write-off on a loan for which the conditions were met by the customer during the year.

25. Segmental information

Segmental information is presented in respect of the Group's business and geographical segments. The primary reporting format, business segments, reflects the manner in which financial information is evaluated by the Board of Directors and the Group Management Committee.

25.1 Business segments

For financial reporting purposes, the Group is organised into four main operating segments:-

- Wholesale banking: the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers.

- 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 and trading activities and the management of the Group's balance sheet, including funding.

- Asset management and investment banking: the provision of asset and fund management services, and of financial advisory services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.

- Head office and support units: income arising on the investment of the Group's net free capital funds and expenses incurred by support units, including the investment in the retail banking strategy prior to the launch of all planned retail banking products and services.

The results reported for the business segments are based on the Group's internal financial reporting systems, which report interest revenue and interest expense on a net basis. The accounting policies of the segments are the same as those applied in the preparation of these consolidated financial statements and are 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. Liabilities reported for head office and support units comprise retail-related deposits and senior term finance facilities and related accrued interest, the cost of which is recharged to the relevant operating business segments.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

25. Segmental information (continued)

25.1 Business segments (continued)
The business segment analysis is as follows:-

	Wholesale banking	Treasury	Asset management and investment banking	Head office and support units	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
2017					
Net interest income	**147.1**	**79.7**	**0.1**	**26.2**	**253.1**
Total income	**186.6**	**100.5**	**37.5**	**35.7**	**360.3**
Segment result	**106.0**	**90.9**	**20.1**	**(140.4)**	**76.6**
Taxation charge					**(6.6)**
Net income after tax					**70.0**
Segment assets	**10,150.3**	**14,802.3**	**68.5**	**450.2**	**25,471.3**
Segment liabilities	**1,148.8**	**17,423.5**	**-**	**4,488.1**	**23,060.4**
Total equity					**2,410.9**
Total liabilities and equity					**25,471.3**
2016					
Net interest income	101.7	69.6	0.1	18.6	190.0
Total income	150.0	94.9	31.8	23.3	300.0
Segment result	48.2	84.4	17.0	(108.5)	41.1
Taxation charge					(3.8)
Net income after tax					37.3
Segment assets	9,868.5	12,624.3	67.5	345.5	22,905.8
Segment liabilities	-	17,662.4	-	2,886.0	20,548.4
Total equity					2,357.4
Total liabilities and equity					22,905.8

25.2 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 total income and total assets based on the location in which transactions are booked and income is recorded was as follows:-

	2017		2016	
	Total income	**Total assets**	Total income	Total assets
	US$ millions	**US$ millions**	US$ millions	US$ millions
GCC	**275.8**	**18,493.2**	231.2	17,066.6
Other countries	**84.5**	**6,978.1**	68.8	5,839.2
	360.3	**25,471.3**	300.0	22,905.8

The geographical analyses of deposits and risk assets are set out in notes 13 and 27 respectively.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. 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, including approving obligor limits by rating, industry and geography, and the review of rating back-testing exercises. 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 Risk 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, including approval of LGDs and eligible collateral for ECL calculations. 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. The Provisioning Committee approves the categorisation of an exposure as stage 1, stage 2 or stage 3. Periodic reviews by internal 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 described in detail in the Basel 3 Pillar 3 disclosure report in the Annual Report, and are summarised below together with additional quantitative analyses:-

26.1 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.

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 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 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.

The Group also mitigates its credit exposures on foreign exchange and derivative financial instruments through the use of master netting agreements and collateral arrangements.

Significant increase in credit risk

When determining whether the risk of default on a financial instrument has increased significantly since initial recognition, the Group considers reasonable and supportable information that is relevant and available without undue cost or effort. This includes both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and expert credit assessment and inclusion of forward-looking information.

The Group considers all counterparties internally rated 6+ and below to be significantly deteriorated, as they are below the minimum credit quality thresholds specified in the Group's credit policy. In addition, the Group also considers all counterparties internally rated 2 and above, between 2- and 3+, between 3 and 4+, and 4 and below, to be significantly deteriorated where they have been downgraded 6 notches, 5 notches, 4 notches and 3 notches respectively since initial recognition, and where the current pricing has not been adjusted to reflect the new risk profile of the counterparty.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

Debt investment securities are considered to have low credit risk when their credit risk rating is equivalent to an investment grade rating or a debt investment security with similar credit risk characteristics.

The criteria for determining whether credit risk has increased significantly vary by portfolio and include quantitative changes in the probability of default (PDs) and qualitative factors, including whether the exposure has been watch-listed, whether the exposure is more than 30 days past due and as a backstop based on delinquency.

Definition of default

The Group considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Group in full, without recourse by the Group to actions such as liquidating collateral; or the borrower is past due more than 90 days on any credit obligation to the Group. In assessing whether a borrower is in default, the Group considers both qualitative factors such as breaches of covenants and quantitative factors such as overdue status and non-payment on another obligation of the same issuer to the Group.

Incorporation of forward-looking information

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

The Group has identified economic factors such as the International Monetary Fund (IMF) trends in fiscal balances and GDP growth in key markets of the Kingdom of Saudi Arabia, United Arab Emirates and United States of America as well as the views of the Chief Economist. Given the nature of the Group's exposures and availability of historical statistically reliable information, the Group derives the point-in-time (PIT) probability of default (PD) using the through-the-cycle (TTC) PD data published by Standard & Poors (S&P) for each rating category. The Group uses the Vasicek model to link the TTC PDs with forward looking economic factors to drive PIT PD estimates for each rating category. The Vasicek model takes into consideration forward looking economic forecasts under three scenarios (base case, negative case, and positive case), historical economic data, the asset correlation of each rating category (as per the Basel IRB economic capital formula), and TTC PDs for deriving PIT PDs. The relationship between the economic factors and default and loss rates have been developed using internal historical data and relevant external market data.

Measurement of ECL

The key input parameters into the measurement of ECL are the probability of default (PD), loss given default (LGD) and exposure at default (EAD). These parameters are derived from internally developed statistical models, other historical data using both internal and external factors, and incorporates forward-looking information.

PD estimates are estimates at a certain date, and are calculated using Standard & Poor's recovery studies data after consideration of the contractual maturities of exposures and estimated prepayment rates and are derived using the Vasicek model.

The PIT PD estimates are converted to cumulative PIT PDs for exposures that have tenors in excess of one year and that are assessed on lifetime PDs. The lifetime PDs are calculated by compounding the 12 month PIT PDs.

LGD is the magnitude of the likely loss if there is a default. The Group estimates LGD parameters based on the history of recovery rates of claims against defaulted counterparties, based on historical data using both internal and external factors.

EAD represents the expected exposure in the event of a default. The Group derives the EAD from the current exposure to the counterparty and potential changes to the current amounts allowed under the contract including amortisation. The EAD of a financial asset is its gross carrying amount. For lending commitments and financial guarantees, the EAD is converted to balance sheet equivalents.

Subject to a maximum of 12-month PD for financial assets for which credit risk has not significantly increased, the Group measures ECL considering the risk of default over the maximum contractual period over which it is exposed to credit risk.

Where modelling of a parameter is carried out on a collective basis, the financial instruments are grouped on the basis of shared risk characteristics including instrument type, credit risk ratings and geographic location of the borrower.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

The Group calculates PIT PD estimates under three scenarios, a base case, negative case and positive case. A probability weighted ECL is then calculated by assigning probabilities, based on current market conditions, to each scenario. At 31st December 2017, the probabilities assigned to the base case, negative case and positive case scenarios were in the ratio of 50:35:15 respectively (2016: 60:20:20).

Credit-impaired loans

Credit-impaired loans and advances are graded 8 to 10 in the Group's internal credit risk grading systems.

Modified financial assets

The contractual terms of a loan may be modified for a number of reasons including changing market conditions, and other factors not related to the current or potential credit deterioration of a customer. When the terms of a financial asset are modified and the modification does not result in derecognition, the determination of whether the asset's credit risk has increased significantly reflects a comparison of its remaining lifetime PD at the reporting date based on modified terms, with the remaining lifetime PD estimated based on data at initial recognition and the original contractual terms.

The Group renegotiates loans to customers in financial difficulties to maximise collection opportunities and minimise the risk of default. The Group grants forbearance on a selective basis if there is evidence that the customer has made all reasonable efforts to honour the original contractual terms and the customer is expected to be able to meet the revised terms. Forbearance is a qualitative indicator of a significant increase in credit risk, and a customer would need to demonstrate consistently good payment behaviour over a period of time before the exposure is no longer considered to be credit-impaired, or in default, or the PD has decreased such that the provision for credit-impairment reverts to being measured at an amount equal to the 12-month ECL.

a) Maximum exposure to credit risk

The gross maximum exposure to credit risk before applying collateral, guarantees and other credit enhancements was as follows:-

	31.12.17	31.12.16
	US$ millions	US$ millions
Balance sheet items:		
Cash and other liquid assets	**3,768.5**	3,095.0
Securities purchased under agreements to resell	**855.0**	635.0
Placements	**6,033.2**	4,715.3
Trading securities	**191.8**	91.9
Investment securities	**3,993.8**	4,066.4
Loans and advances	**10,043.1**	9,745.1
Accrued interest receivable	**214.7**	167.1
Total on-balance sheet credit exposure	**25,100.1**	22,515.8
Off-balance sheet items:		
Credit-related contingent items	**5,027.9**	4,296.6
Foreign exchange-related items	**59.2**	110.4
Derivative-related items	**142.3**	110.8
Equity and commodity contracts	**1.8**	2.4
Total off-balance sheet credit exposure	**5,231.2**	4,520.2
Total gross credit exposure	**30,331.3**	27,036.0

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

b) Credit risk profile

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium-term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits.

The internal credit rating system also serves as a key input into the Group's risk-adjusted return on capital (RAROC) performance measurement system.

The internal ratings map directly to the external rating grades used by the international credit rating agencies as follows:-

Internal rating grade	Internal classification	Fitch and Standard & Poor's	Moody's
Investment grade			
Rating grade 1	Standard	AAA	Aaa
Rating grade 2	Standard	AA	Aa
Rating grade 3	Standard	A	A
Rating grade 4	Standard	BBB	Baa
Sub-investment grade			
Rating grade 5	Standard	BB	Ba
Rating grade 6	Standard	B	B
Rating grade 7	Standard	CCC	Caa
Classified			
Rating grade 8	Substandard	CC	Ca
Rating grade 9	Doubtful	C	C
Rating grade 10	Loss	D	-

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

b) Credit risk profile (continued)
The credit risk profile, based on internal credit ratings, was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	31.12.17 Credit-related contingent items
	US$ millions	US$ millions	US$ millions	US$ millions
Stage 1 (12-month ECL)				
Rating grades 1 to 4-	10,533.0	3,593.8	5,945.7	3,154.1
Rating grades 5+ to 5-	99.1	229.3	3,064.2	647.9
Rating grades 6+ to 6-	24.6	-	114.4	63.2
Rating grade 7	-	-	0.2	-
Equity investments	-	170.7	-	3.2
Carrying amount (net)	10,656.7	3,993.8	9,124.5	3,868.4
Stage 2 (Lifetime ECL but not credit-impaired)				
Rating grades 1 to 4-	-	-	10.7	0.3
Rating grades 5+ to 5-	-	-	363.9	80.3
Rating grades 6+ to 6-	-	-	321.4	1,013.3
Rating grade 7	-	-	103.8	-
Carrying amount (net)	-	-	799.8	1,093.9
Stage 3 (Lifetime ECL and credit-impaired)				
Rating grade 8	-	-	90.0	52.9
Rating grade 9	-	-	28.8	12.3
Rating grade 10	-	-	-	0.4
Carrying amount (net)	-	-	118.8	65.6
	10,656.7	3,993.8	10,043.1	5,027.9

The above analysis is reported net of the following provisions for impairment:-

Stage 1	-	(4.5)	(46.3)	-
Stage 2	-	-	(106.3)	-
Stage 3	-	-	(261.0)	-
Total	-	(4.5)	(413.6)	-

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

b) Credit risk profile (continued)

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	31.12.16 Credit-related contingent items
	US$ millions	US$ millions	US$ millions	US$ millions
Stage 1 (12-month ECL)				
Rating grades 1 to 4-	8,352.5	3,603.0	5,504.8	2,259.4
Rating grades 5+ to 5-	92.8	212.3	3,279.5	1,815.1
Rating grades 6+ to 6-	-	-	194.8	20.4
Rating grade 7	-	-	6.8	25.5
Equity investments	-	251.1	-	3.1
Carrying amount (net)	8,445.3	4,066.4	8,985.9	4,123.5
Stage 2 (Lifetime ECL but not credit-impaired)				
Rating grades 5+ to 5-	-	-	371.3	-
Rating grades 6+ to 6-	-	-	226.3	122.5
Carrying amount (net)	-	-	597.6	122.5
Stage 3 (Lifetime ECL and credit-impaired)				
Rating grade 7	-	-	10.7	-
Rating grade 8	-	-	114.9	44.2
Rating grade 9	-	-	1.6	3.2
Rating grade 10	-	-	34.4	3.2
Carrying amount (net)	-	-	161.6	50.6
	8,445.3	4,066.4	9,745.1	4,296.6

The above analysis is reported net of the following provisions for impairment:-

Stage 1	-	(4.5)	(82.5)	-
Stage 2	-	-	(83.0)	-
Stage 3	-	-	(255.5)	-
Total	-	(4.5)	(421.0)	-

The 7-rated stage 1 exposure at 31st December 2017 and 31st December 2016 largely related to a past due but not impaired loan exposure guaranteed by a government export credit agency.

The 6+ to 6- stage 2 credit-related contingent exposure at 31st December 2017 principally represented the gross principal amount of a guarantee for which there were counter-indemnities provided by investment grade-rated financial institutions amounting to US$724.1 million.

Stage 3 financial assets represent assets for which 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 obligation.

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees. The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market / fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. Collateral is not usually held against securities or placements and no such collateral was held at either 31st December 2017 or 31st December 2016.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.1 Credit risk (continued)

b) Credit risk profile (continued)

The Group held collateral amounting to US$36.9 million that was considered as a credit enhancement and hence reduced the ECL of stage 3 financial assets at 31st December 2017 (2016: US$75.7 million).

An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 30 while the notional and risk-weighted exposures for off-balance sheet credit-related financial instruments are set out in note 31.

c) Credit risk concentration

The Group monitors concentrations of credit risk by sector and by geographic location. The industrial classification of loans and advances is set out in note 10.2. The geographical distribution of risk assets is set out in note 27. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 30.

d) Settlement risk

Settlement risk is the risk of loss due to the failure of a counterparty to honour its obligations to deliver cash, securities, or other assets as contractually agreed.

For certain types of transactions, the Group mitigates this risk by conducting settlements through a settlement or clearing agent to ensure that a trade is settled only when both parties have fulfilled their contractual settlement obligations. Settlement limits form part of the credit approval and limit monitoring process.

26.2 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.

a) 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, credit 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. It is recognised that there are limitations to the VaR methodology. These limitations include the fact that the historical data may not be the best proxy for future price movements. The Group performs regular back testing exercises to compare actual profits and losses with the VaR estimates to monitor the statistical validity of the VaR model. VaR is calculated based on the Group's market risk exposures at the close of the business each day. Intra-day risk levels may vary from those reported at the end of the day. In addition, losses beyond the specified confidence level are not captured by the VaR methodology. VaR is not a measure of the absolute limit of market risk and losses in excess of the VaR amounts will, on occasion, arise. To manage the risk associated with extreme market movements, the Group conducts stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. The composition of the debt and equity trading securities is set out in note 8. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 30.

The VaR for the Group's trading positions, as calculated in accordance with the basis set out in note 33, was as follows:-

				2017				2016
	31.12.17	**Average**	**High**	**Low**	31.12.16	Average	High	Low
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	US$ millions	US$ millions	US$ millions	US$ millions
Total VaR	**1.8**	**1.8**	**2.5**	**0.1**	0.4	0.2	0.5	-
Total undiversified stressed VaR	**5.1**	**4.1**	**5.3**	**0.3**	0.6	0.3	0.9	0.1

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

26. Risk management (continued)

26.2 Market risk (continued)

b) 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 are set out in note 29. Movements in the fair value of equity investment securities are accounted for in other comprehensive income. The Group does not maintain material foreign currency exposures. In general, the Group's policy is to match financial 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 30.5.

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

26.3 Liquidity risk

Liquidity risk is the risk that sufficient funds are not available to meet the Group's financial obligations on a punctual basis as they fall due.

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.

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within limits set and approved by the Board of Directors. The limits take account of the depth and liquidity of the market in which the entity operates. It is the Group's general policy that each geographic entity should be self-sufficient in relation to funding its own operations.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.3 Liquidity risk (continued)

The Group's liquidity management policies include the following:-

- the monitoring of (i) future contractual cash flows against approved limits, and (ii) the level of liquid resources available in a stress event;
- the monitoring of balance sheet liquidity ratios;
- the monitoring of the sources of funding in order to ensure that funding is derived from a diversified range of sources;
- the monitoring of depositor concentrations in order to avoid undue reliance on individual depositors;
- the maintenance of a satisfactory level of term financing;
- the maintenance of appropriate standby funding arrangements; and
- the maintenance of liquidity and funding contingency plans. These plans identify early indicators of stress conditions and prescribe the actions to be taken in the event of systemic or other crisis, while minimising adverse long-term implications for the Group's business activities.

The Group has established approved limits which restrict the volume of liabilities maturing in the short-term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 30 day period. The liquidity limits ensure that the net cash outflows over a 30 day period do not exceed the eligible stock of available liquid resources. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

Customer deposits form a significant part of the Group's funding. The Group places considerable importance on maintaining the stability of both its customer and interbank deposits. The stability of deposits depends on maintaining confidence in the Group's financial strength and financial transparency.

The maturity profile of assets and liabilities is set out in note 28. An analysis of debt investment securities by rating classification is set out in note 26.1.

26.4 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.

26.5 Capital management

The Group's lead regulator, the Central Bank of Bahrain (CBB), sets and monitors capital requirements for the Group as a whole. The parent company and individual banking operations are directly supervised by their local regulators.

As referred to in more detail in note 33, the Group adopted Basel 3 capital adequacy framework with effect from 1st January 2015 as required by the CBB.

In applying current capital requirements, the CBB requires the Group to maintain a prescribed minimum ratio of total regulatory capital to total risk-weighted assets. The CBB's minimum risk asset ratio is 12.5 per cent compared to a minimum ratio of 8 per cent prescribed by the Basel Committee on Banking Supervision. The Group calculates regulatory capital requirements for general market risk in its trading portfolios using a Value-at-Risk model and uses the CBB's prescribed risk-weightings under the standardised approach to determine the risk-weighted amounts for credit risk and specific market risk. Operational risk is calculated in accordance with the standardised approach. The regulatory capital requirement is calculated by applying the CBB's prescribed range of beta coefficients, ranging from 12 to 18 per cent, to the average gross income for the preceding three financial years for each of eight predefined business lines.

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

- Tier 1 capital, comprising issued share capital, share premium, retained earnings and reserves, adjusted to exclude revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions.
- Tier 2 capital, comprising qualifying subordinated term finance and stage 1 and stage 2 impairment provisions for loans and advances, after applicable haircuts and ceiling limitations.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

26. Risk management (continued)

26.5 Capital management (continued)

The CBB applies various limits to elements of the regulatory capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier 1 capital. There are also restrictions on the amount of stage 1 and stage 2 impairment provisions that may be included as part of tier 2 capital.

The Group's risk exposures are categorised as either trading book or banking book, and risk-weighted assets are determined according to specified requirements that seek to reflect the varying levels of risk attached to assets and off-balance sheet exposures.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout and the issue of new shares.

The Group complied with all externally imposed capital requirements throughout the years ended 31st December 2017 and 31st December 2016.

There have been no material changes in the Group's management of capital during the years ended 31st December 2017 and 31st December 2016.

The capital adequacy ratio calculation is set out in note 33.

27. Geographical distribution of risk assets

					31.12.17	31.12.16
	Placements, reverse repos & 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	**3,481.2**	**2,386.8**	**9,828.8**	**4,398.9**	**20,095.7**	18,278.3
Other Middle East & North Africa	**20.0**	**2.7**	**6.3**	**0.9**	**29.9**	27.4
Europe	**5,657.5**	**670.3**	**160.3**	**299.3**	**6,787.4**	6,304.6
North America	**1,104.6**	**587.7**	**29.6**	**295.8**	**2,017.7**	1,286.5
Asia	**393.4**	**518.4**	**18.1**	**33.0**	**962.9**	735.9
Latin America	**-**	**19.7**	**-**	**-**	**19.7**	12.6
	10,656.7	**4,185.6**	**10,043.1**	**5,027.9**	**29,913.3**	26,645.3

At 31st December 2017, risk exposures to customers and counterparties in the GCC represented 67.2 per cent (2016: 68.6 per cent) of total risk assets. The risk asset profile reflects the Group's strategic focus on wholesale banking activities in the GCC states.

Placements, reverse repos and other liquid assets exposure to Europe principally comprised exposure to financial institutions located in the United Kingdom, Netherlands, Switzerland and France.

An analysis of derivative and foreign exchange instruments is set out in note 30.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

28. Maturities of assets and liabilities

The maturity profile of the carrying amount of assets, liabilities and equity, based on the contractual maturity dates, was as follows:-

	Within 3 months	4 months to 1 year	Years 2 and 3	Years 4 and 5	Over 5 years and other	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2017						
Cash and other liquid assets	3,715.6	39.5	-	-	13.4	3,768.5
Securities purchased under agreements to resell	655.0	100.0	100.0	-	-	855.0
Placements	4,977.7	815.4	240.1	-	-	6,033.2
Trading securities	-	-	13.0	-	178.8	191.8
Investment securities	319.9	357.2	882.2	660.3	1,774.2	3,993.8
Loans and advances	3,357.0	2,527.1	2,023.2	1,124.3	1,011.5	10,043.1
Other assets	333.4	38.8	20.7	11.6	181.4	585.9
Total assets	**13,358.6**	**3,878.0**	**3,279.2**	**1,796.2**	**3,159.3**	**25,471.3**
Deposits	15,414.3	2,656.6	44.4	3.6	-	18,118.9
Securities sold under agreements to repurchase	729.1	401.4	-	-	-	1,130.5
Other liabilities	266.3	33.4	15.7	8.7	223.3	547.4
Term financing	25.3	666.4	1,323.9	1,069.5	178.5	3,263.6
Equity	-	-	-	-	2,410.9	2,410.9
Total liabilities & equity	**16,435.0**	**3,757.8**	**1,384.0**	**1,081.8**	**2,812.7**	**25,471.3**
At 31st December 2016						
Total assets	11,134.9	3,677.1	3,831.0	1,902.4	2,360.4	22,905.8
Total liabilities & equity	13,679.9	4,371.3	1,759.8	541.3	2,553.5	22,905.8

The asset and liability maturities presented in the table above 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. 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 2017

28. Maturities of assets and liabilities (continued)

The gross cash flows payable by the Group under financial liabilities, based on contractual maturity dates, was as follows:-

	Within 3 months	4 months to 1 year	Years 2 and 3	Years 4 and 5	Over 5 years and other
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2017					
Deposits	**15,602.6**	**2,755.9**	**47.3**	**3.9**	**-**
Securities sold under agreements to repurchase	**733.0**	**406.1**	**-**	**-**	**-**
Term financing	**26.8**	**705.8**	**1,402.2**	**1,132.8**	**189.1**
Derivative financial instruments					
- contractual amounts payable	**100.3**	**157.1**	**261.3**	**173.1**	**192.8**
- contractual amounts receivable	**(70.5)**	**(125.5)**	**(207.5)**	**(124.6)**	**(133.1)**
Total undiscounted financial liabilities	**16,392.2**	**3,899.4**	**1,503.3**	**1,185.2**	**248.8**
At 31st December 2016					
Deposits	12,658.6	3,628.0	3.9	-	-
Securities sold under agreements to repurchase	987.4	340.7	-	-	-
Term financing	-	527.5	1,818.6	562.5	5.4
Derivative financial instruments					
- contractual amounts payable	77.9	143.9	196.9	108.0	110.8
- contractual amounts receivable	(103.5)	(103.2)	(117.6)	(53.9)	(44.4)
Total undiscounted financial liabilities	13,620.4	4,536.9	1,901.8	616.6	71.8

Information on the contractual terms for the drawdown of gross loan commitments is set out in note 31.

The figures in the table above do not agree directly to the carrying amounts in the consolidated statement of financial position as they incorporate all cash flows, on an undiscounted basis, related to both principal as well as those associated with future coupon and interest payments. Coupons and interest payments for periods for which the interest rate has not yet been determined have been calculated based on the relevant forward rates of interest prevailing at the balance sheet date.

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 30.3.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

29. Interest rate risk

The repricing profile of assets and liabilities categories and equity were as follows:-

	Within 3 months	Months 4 to 6	Months 7 to 12	Over 1 year	Non-interest bearing items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2017						
Cash and other liquid assets	3,715.6	39.5	-	-	13.4	3,768.5
Securities purchased under agreements to resell	755.0	100.0	-	-	-	855.0
Placements	5,097.8	418.8	516.6	-	-	6,033.2
Trading securities	13.0	-	-	-	178.8	191.8
Investment securities						
- Fixed rate	274.9	50.0	135.0	718.1	-	1,178.0
- Floating rate	2,618.9	30.7	-	-	(4.5)	2,645.1
- Equities	-	-	-	-	170.7	170.7
Loans and advances	8,669.3	1,443.9	82.5	-	(152.6)	10,043.1
Other assets	-	-	-	-	585.9	585.9
Total assets	21,144.5	2,082.9	734.1	718.1	791.7	25,471.3
Deposits	16,592.1	1,122.5	375.3	29.0	-	18,118.9
Securities sold under agreements to repurchase	940.8	189.7	-	-	-	1,130.5
Other liabilities	-	-	-	-	547.4	547.4
Term financing	3,263.6	-	-	-	-	3,263.6
Equity	-	-	-	-	2,410.9	2,410.9
Total liabilities & equity	20,796.5	1,312.2	375.3	29.0	2,958.3	25,471.3
Interest rate sensitivity gap	348.0	770.7	358.8	689.1	(2,166.6)	-
Cumulative interest rate sensitivity gap	348.0	1,118.7	1,477.5	2,166.6	-	-
At 31st December 2016						
Cumulative interest rate sensitivity gap	613.3	1,797.0	1,118.1	2,089.3	-	-

The repricing profile is based on the remaining period to the next interest repricing date. 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 stage 1 and stage 2 investment security and loan provisions are classified in non-interest bearing items.

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. At 31st December 2017, the modified duration of these fixed rate securities was 3.24. 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 was US$280,700.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

29. Interest rate risk (continued)

Based on the repricing profile at 31st December 2017, 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 an increase in net income before tax for the following year by approximately US$14.2 million and an increase in the Group's equity by US$14.4 million. 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 26. The market risk relating to derivative and foreign exchange instruments classified as FVTPL is set out in note 30.

30. Derivatives 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, credit 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.

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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

30. Derivatives and foreign exchange instruments (continued)

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 and sold by the Group are classified as derivative financial instruments.

30.1 Product analysis

The table below summarises the aggregate notional and credit risk amounts of foreign exchange, interest rate and commodity contracts.

			Notional amounts	Credit risk
	Trading	**Hedging**	**Total**	**amounts**
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**
At 31st December 2017				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	**6,727.9**	**-**	**6,727.9**	**50.8**
Options purchased	**770.8**	**-**	**770.8**	**8.4**
Options written	**770.8**	**-**	**770.8**	**-**
	8,269.5	**-**	**8,269.5**	**59.2**
Interest rate contracts:-				
Interest rate swaps	**4,504.1**	**12,629.1**	**17,133.2**	**118.6**
Cross currency swaps	**1,451.8**	**-**	**1,451.8**	**-**
Options, caps and floors purchased	**1,165.2**	**-**	**1,165.2**	**23.7**
Options, caps and floors written	**1,165.2**	**-**	**1,165.2**	**-**
	8,286.3	**12,629.1**	**20,915.4**	**142.3**
Equity and commodity contracts:-				
Options and swaps purchased	**86.6**	**-**	**86.6**	**1.8**
Options and swaps written	**86.6**	**-**	**86.6**	**-**
	173.2	**-**	**173.2**	**1.8**
	16,729.0	**12,629.1**	**29,358.1**	**203.3**
At 31st December 2016	13,817.0	12,104.2	25,921.2	223.6

There is no credit risk in respect of options written as they represent obligations of the Group.

At 31st December 2017, the Value-at-Risk of the foreign exchange, interest rate and equity and commodity trading contracts analysed in the table above was US$0.1 million, nil and nil respectively (2016: US$0.3 million, US$0.1 million and nil respectively). Value-at-Risk is a measure of market risk exposure and represents an estimate, with a 99 per cent level of confidence, of the potential loss that might arise if the positions were to be held unchanged for ten consecutive business days. The estimate is based on a twelve month historical observation period of unweighted data from the DataMetrics data set.

30.2 Counterparty analysis

			31.12.17	31.12.16
	Banks	**Corporates**	**Total**	Total
	US$ millions	**US$ millions**	**US$ millions**	US$ millions
OECD countries	**108.7**	**35.5**	**144.2**	164.9
GCC countries	**7.8**	**51.3**	**59.1**	58.7
	116.5	**86.8**	**203.3**	223.6

Credit risk is concentrated on major OECD-based banks.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

30. Derivatives and foreign exchange instruments (continued)

30.3 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 31st December 2017					
Foreign exchange contracts	**8,155.7**	**113.8**	**-**	**-**	**8,269.5**
Interest rate contracts	**10,157.2**	**3,381.6**	**2,539.8**	**4,836.8**	**20,915.4**
Equity and commodity contracts	**50.7**	**45.3**	**77.2**	**-**	**173.2**
	18,363.6	**3,540.7**	**2,617.0**	**4,836.8**	**29,358.1**
At 31st December 2016	17,850.4	5,011.3	964.9	2,094.6	25,921.2

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 or cash flow hedges.

30.4 Fair value analysis

	31.12.17 Positive fair value	**31.12.17** Negative fair value	31.12.16 Positive fair value	31.12.16 Negative fair value
	US$ millions	US$ millions	US$ millions	US$ millions
Derivatives classified as FVTPL:-				
Foreign exchange contracts	**13.1**	**(12.7)**	52.7	(53.4)
Interest rate contracts	**125.7**	**(115.5)**	85.4	(75.8)
Equity and commodity contracts	**3.3**	**(3.3)**	3.0	(3.0)
	142.1	**(131.5)**	141.1	(132.2)
Derivatives held as fair value hedges:-				
Interest rate contracts	**40.1**	**-**	27.8	-
Amount included in other assets / (other liabilities)	**182.2**	**(131.5)**	168.9	(132.2)

30.5 Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2017 or at 31st December 2016.

30.6 Hedge accounting

The Group offers fixed rate liability and asset products to clients in the normal course of business. The interest rate received or paid is fixed for the term of the transaction, exposing the Group to interest rate risk during the life of the transaction.

In order to mitigate this interest rate market risk exposure, the Group uses interest rate swaps in one-to-one, one-to-many and many-to-many relationships. The derivative products effectively tie a floating interest rate to the fixed rate client transaction. The hedging item is executed at the same time that the client-related transaction, the hedged item, is booked.

Generally, the hedging item executed exactly matches the critical terms of the hedged item, that being the nominal value, currency, trade date and maturity date and hence the hedge ratio is expected to remain close to 100 per cent. The hedging relationship is generally highly effective because the critical terms of the instruments match at inception and will remain effective throughout the contractual term of the derivative until maturity. The critical terms are reviewed every reporting date to ensure that the match persists.

The Group's derivative instruments are also subject to credit risk. Credit risk can arise on both the hedging instrument and the hedged item in the form of counterparty credit risk or the Group's own credit risk. The Group mitigates its credit exposure through the use of master netting arrangements and collateral arrangements as set out in note 26.1 and credit risk is therefore, unlikely to dominate the change in fair value of such hedging instruments.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

30. Derivatives and foreign exchange instruments (continued)

30.6 Hedge accounting (continued)
The hedging relationship is tested at each reporting date by comparing the fair value of the hedging instrument with that of the hedged instrument. If, as a result of the testing, there is a deviation to the hedge ratio then ineffectiveness is recognised in the consolidated statement of income. The hedging relationship is subsequently either rebalanced or discontinued in accordance with the Group's Board-approved policies and procedures.

The hedging instruments comprise hedges of fixed rate asset and fixed rate liability products with the following maturity profile:-

	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Notional amounts					
At 31st December 2017					
Fixed rate asset products	**3,046.0**	**1,256.4**	**562.7**	**1,340.4**	**6,205.5**
Fixed rate liability products	**5,386.9**	**533.1**	**503.6**	**-**	**6,423.6**
At 31st December 2016					
Fixed rate asset products	3,843.2	1,109.0	468.0	870.0	6,290.2
Fixed rate liability products	4,923.7	890.3	-	-	5,814.0

Gains and losses recognised in the consolidated statement of income relating to fair value hedging relationships were as follows:-

	2017	2016
	US$ millions	US$ millions
Net gains on derivatives fair value hedging instruments	**15.8**	47.5
Net losses on hedged items attributable to the hedged risk	**(15.8)**	(47.5)

The notional amount, fair values, and changes in fair values of hedging instruments for the year ended 31st December 2017 used as the basis for recognising hedge ineffectiveness were as follows:-

	Notional amount	Fair value	Changes in fair value
	US$ millions	US$ millions	US$ millions
At 31st December 2017			
Financial assets			
Interest rate contracts	**8,950.6**	**53.7**	**12.5**
Financial liabilities			
Interest rate contracts	**3,678.5**	**(5.8)**	**3.3**
	12,629.1	**47.9**	**15.8**
At 31st December 2016			
Financial assets			
Interest rate contracts	8,043.9	41.2	49.2
Financial liabilities			
Interest rate contracts	4,060.3	(9.1)	(1.7)
	12,104.2	32.1	47.5

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

30. Derivatives and foreign exchange instruments (continued)

30.6 Hedge accounting (continued)

The carrying amount, accumulative changes in fair values, and changes in fair values of hedged instruments for the year ended 31st December 2017 used as the basis for recognising hedge ineffectiveness were as follows:-

	Notional amount	Fair value	Changes in fair value
	US$ millions	US$ millions	US$ millions
At 31st December 2017			
Financial assets			
Placements and securities purchased under agreement to resell	**2,784.2**	**(1.3)**	**0.1**
Loans and advances	**474.4**	**(7.8)**	**1.4**
Investment securities	**2,946.9**	**(40.1)**	**(12.3)**
	6,205.5	**(49.2)**	**(10.8)**
Financial liabilities			
Deposits and securities sold under agreement to repurchase	**5,603.0**	**1.6**	**2.0**
Senior term financing	**820.6**	**(0.3)**	**(7.0)**
	6,423.6	**1.3**	**(5.0)**
	12,629.1	**(47.9)**	**(15.8)**
At 31st December 2016			
Financial assets			
Placements and securities purchased under agreement to resell	2,937.2	(1.4)	(1.4)
Loans and advances	771.4	(9.2)	(7.9)
Investment securities	2,581.6	(27.8)	(37.0)
	6,290.2	(38.4)	(46.3)
Financial liabilities			
Deposits and securities sold under agreement to repurchase	4,923.6	(0.4)	(0.5)
Senior term financing	890.4	6.7	(0.7)
	5,814.0	6.3	(1.2)
	12,104.2	(32.1)	(47.5)

There were no ineffective portions of derivative fair value or cash flow hedging transactions recognised in the consolidated statement of income in either the years ended 31st December 2017 or 31st December 2016.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

31. 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 notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated in accordance with the CBB's Basel 3 guidelines were as follows:-

		31.12.17		31.12.16
	Notional principal amount	**Risk-weighted exposure**	Notional principal amount	Risk-weighted exposure
	US$ millions	**US$ millions**	US$ millions	US$ millions
Direct credit substitutes	**672.3**	**654.3**	627.1	619.3
Transaction-related contingent items	**2,020.7**	**785.2**	2,009.9	773.2
Short-term self-liquidating trade-related contingent items	**515.2**	**87.8**	442.8	79.4
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**1,819.7**	**830.2**	1,216.8	526.1
	5,027.9	**2,357.5**	4,296.6	1,998.0

Commitments may be drawndown on demand.

Direct credit substitutes at 31st December 2017 included financial guarantees amounting to US$544.8 million (2016: US$403.5 million). Financial guarantees may be called on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2017, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US$330.7 million (2016: US$316.0 million).

32. Contingent liabilities

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.

33. Capital adequacy

The Group adopted the Basel 3 capital adequacy framework with effect from 1st January 2015. The CBB's Basel 3 guidelines became effective on 1st January 2015 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 3 capital adequacy framework for banks incorporated in the Kingdom of Bahrain. The Group complied with all externally imposed capital requirements for the years ended 31st December 2017 and 31st December 2016.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

33. Capital adequacy (continued)

The risk asset ratio calculated in accordance with the CBB's Basel 3 guidelines was as follows:-

	31.12.17	31.12.16
	US$ millions	US$ millions
Regulatory capital base		
Tier 1 capital:		
Total equity	2,410.9	2,357.4
Tier 1 adjustments	-	-
Tier 1 capital	2,410.9	2,357.4
Tier 2 capital:		
Stage 1 and stage 2 loan provisions	152.6	165.5
Tier 2 capital	152.6	165.5
Total regulatory capital base	2,563.5	2,522.9

	Notional principal amount	Risk-weighted exposure	Notional principal amount	Risk-weighted exposure
	US$ millions	US$ millions	US$ millions	US$ millions
Risk-weighted exposure				
Credit risk				
Balance sheet items:				
Cash and other liquid assets	3,768.5	118.0	3,095.0	82.9
Securities purchased under agreements to resell	855.0	7.8	635.0	3.8
Placements	6,033.2	1,083.4	4,715.3	985.3
Investment securities	3,993.8	1,170.5	4,066.4	1,265.8
Loans and advances	10,043.1	9,515.9	9,745.1	9,322.9
Other assets, excluding derivative-related items	403.7	708.9	388.2	497.3
		12,604.5		12,158.0
Off-balance sheet items:				
Credit-related contingent items	5,027.9	2,357.5	4,296.6	1,998.0
Foreign exchange-related items	8,269.5	42.2	9,230.3	82.2
Interest rate-related items	20,915.4	259.0	16,592.3	110.6
Equity and commodity contracts	173.2	0.4	98.6	-
Repo counterparty risk	-	30.6	-	21.6
		2,689.7		2,212.4
Credit risk-weighted exposure		15,294.2		14,370.4
Market risk				
General market risk		379.6		27.1
Specific market risk		90.6		43.8
Market risk-weighted exposure		470.2		70.9
Operational risk				
Operational risk-weighted exposure		645.9		578.5
Total risk-weighted exposure		16,410.3		15,019.8
Tier 1 risk asset ratio		14.7%		15.7%
Total risk asset ratio		15.6%		16.8%

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

33. Capital adequacy (continued)

For regulatory Basel 3 purposes, the Group has adopted the standardised approach for credit risk as mandated by CBB for all locally incorporated banks. For market risk, the Group uses the internal models approach. GIB applies the standardised approach for determining the capital requirement for operational risk.

In accordance with the capital adequacy guidelines of the CBB, revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions are excluded from tier 1 capital, while unrealised gains and losses arising on the remeasurement to fair value of equity investment securities classified as fair value through other comprehensive income (FVTOCI) are included in tier 1 capital.

The Group calculates the regulatory capital requirement for general market risk using a Value-at-Risk model. 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 CBB. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at 3.0 (2016: 3.0) by the CBB, representing the regulatory minimum. The CBB market risk framework includes metrics such as a 'stressed VaR' measure in the calculation of the regulatory capital requirement.

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 international minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The regulatory capital requirement for operational risk is calculated by the Group in accordance with the standardised approach. The regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines.

34. 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 2017 was US$15,953.8 million (2016: US$13,030.4 million).

The Group acts as fund manager to a number of investment funds. In its capacity as fund manager, the Group is entitled to performance and management fees. The Group maintains an investment in the funds.

The investors are able to vote by simple majority to remove the Group as the fund manager, without cause, and the Group's aggregate economic interest is less than 20 per cent. As a result, the Group has concluded that it acts as agent for the investors in these cases, and therefore has not consolidated the funds.

The maximum exposure to loss is equal to the carrying amount of the trading securities, which at 31st December 2017 amounted to US$135.6 million (2016: US$48.5 million).

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2017

35. Related party transactions

The Group is owned by the six Gulf Cooperative Council (GCC) governments, with the Public Investment Fund holding a majority (97.2 per cent) controlling stake. The Public Investment Fund is an investment body of the Kingdom of Saudi Arabia. There were no individual or collectively significant transactions with the Public Investment Fund during the years ended 31st December 2017 or 31st December 2016.

The Group transacts with various entities controlled, jointly controlled or significantly influenced by the six GCC governments, these transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not government-related.

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

The compensation of key management personnel was as follows:-

	2017	2016
	US$ millions	US$ millions
Short-term employee benefits	**11.9**	10.4
Post-employment benefits	**0.9**	0.8
	12.8	11.2

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

Post-employment benefits principally comprise compensation paid to personnel on retirement or resignation from the services of the Group.

36. Fair value of financial instruments

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, equity investment securities and derivative financial instruments, which are accounted for at fair value. The fair value represents the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. 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 prices (level 1 measurement) or to the pricing prevailing for similar financial instruments (level 2 measurement) and the use of unobservable inputs in estimation techniques such as discounted cash flow analysis (level 3 measurement).

The valuation methodologies applied are outlined below.

36.1 Trading securities

The fair values of trading securities are based on quoted prices (level 1) or valuation techniques (level 2 or 3).

36.2 Investment securities

The fair values of equity investment securities are based on quoted prices (level 1) or valuation techniques (level 2 or 3). The fair values of debt investment securities are based on quoted market prices (level 1) and approximate the carrying values.

36.3 Loans and advances

The fair values (level 2) of loans on a floating interest rate basis are principally estimated at book value. The fair values (level 3) of impaired loans are 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 values of fixed rate loans are 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. The fair values (level 2) approximate the carrying values.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

36. Fair value of financial instruments (continued)

36.4 Term financing

The fair value of term financing is based on observable market data, including quoted market prices for debt instruments issued by similarly rated financial institutions and with similar maturities, or estimated on a discounted cash flow basis utilising currently prevailing spreads for borrowings with similar maturities. The fair values (level 2) of senior term financing at 31st December 2017 approximate the carrying values.

36.5 Other on-balance sheet items

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

36.6 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. Impairment 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.

36.7 Valuation basis

The valuation basis for financial assets and financial liabilities carried at fair value was as follows:-

	Quoted prices (level 1)	Valuation based on observable market data (level 2)	Other valuation techniques (level 3)
	US$ millions	US$ millions	US$ millions
At 31st December 2017			
Financial assets:			
Trading securities	**165.7**	**0.9**	**25.2**
Investment securities - equities	**108.4**	**-**	**62.3**
Derivative financial instruments	**-**	**182.2**	**-**
Financial liabilities:			
Derivative financial instruments	**-**	**131.5**	**-**
At 31st December 2016			
Financial assets:			
Trading securities	65.6	1.1	25.2
Investment securities - equities	175.3	-	75.8
Derivative financial instruments	-	168.9	-
Financial liabilities:			
Derivative financial instruments	-	132.2	-

Quoted prices include prices obtained from lead managers, brokers and dealers. Investment securities valued based on other valuation techniques comprise private equity investments that have been valued based on price / earnings and price / book ratios for similar entities, discounted cash flow techniques or other valuation methodologies.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

36. Fair value of financial instruments (continued)

36.7 Valuation basis (continued)

During the year ended 31st December 2017, the value of investment securities whose measurement was determined by other valuation techniques (level 3 measurement) decreased by US$13.5 million (2016: decrease of US$23.7 million). The decrease principally comprised changes in assigned valuations as recognised in other comprehensive income.

No transfers out of the level 3 measurement classification occurred during the years ended 31st December 2017 and 31st December 2016. Similarly, no transfers between level 1 and level 2 measurement classifications were made during the years ended 31st December 2017 and 31st December 2016.

Sensitivity of the movement in the fair value of financial instruments in the level 3 category is assessed as not significant to other comprehensive income or total equity.

37. Earnings per share

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

	2017	2016
Net income (US$ millions)	**70.0**	37.3
Weighted average number of shares in issue (millions)	**2,500**	2,500
Basic earnings per share (US$)	**0.03**	0.01

The diluted earnings per share is equivalent to the basic earnings per share set out above.

38. Principal subsidiaries

The principal subsidiary companies were as follows:-

	Principal activities	**Country of incorporation**
Gulf International Bank (UK) Limited	Asset management	United Kingdom
GIB Capital C.J.S.C.	Asset management and investment banking	Kingdom of Saudi Arabia
GIB Markets Limited	Treasury-related	Cayman Islands

The Group's ownership interest in the principal subsidiary companies was 100 per cent for the years ended 31st December 2017 and 31st December 2016.

During the year ended 31st December 2017, GIB Capital's legal structure changed from a limited liability company (L.L.C.) to a closed joint stock company (C.J.S.C.).

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2017

39. Average consolidated statement of financial position

The average consolidated statement of financial position was as follows:-

	31.12.17	31.12.16
	US$ millions	US$ millions
ASSETS		
Cash and other liquid assets	4,744.8	3,300.6
Securities purchased under agreements to resell	735.8	937.8
Placements	5,168.7	4,594.0
Trading securities	162.8	79.5
Investment securities	3,922.6	4,034.6
Loans and advances	10,310.9	9,613.6
Other assets	550.2	497.0
Total assets	**25,595.8**	23,057.1
LIABILITIES		
Deposits from banks	2,275.6	2,642.7
Deposits from customers	16,122.6	13,406.4
Securities sold under agreements to repurchase	742.0	1,490.4
Other liabilities	507.8	461.5
Senior term financing	3,559.3	2,620.9
Subordinated term financing	-	79.2
Total liabilities	**23,207.3**	20,701.1
Total equity	**2,388.5**	2,356.0
Total liabilities & equity	**25,595.8**	23,057.1

Risk management and capital adequacy report

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Risk management and capital adequacy report

Executive summary

The Central Bank of Bahrain (CBB) Basel 3 guidelines prescribe the capital adequacy framework for banks incorporated in the Kingdom of Bahrain. GIB adopted Basel 3 from 1st January 2015 as required by the CBB.

This Risk Management and Capital Adequacy report encompasses the Pillar 3 disclosure requirements prescribed by the CBB based on the Basel Committee's Pillar 3 guidelines. The report contains a description of GIB's risk management and capital adequacy policies and practices, including detailed information on the capital adequacy process.

For regulatory purposes, GIB has adopted the standardised approach for credit risk. GIB uses the internal models approach for market risk and the standardised approach for determining the capital requirement for operational risk.

The disclosed tier 1 and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 3 framework.

GIB's total risk-weighted assets at 31st December 2017 amounted to US$16,410.3 million. Credit risk accounted for 93.2 per cent, market risk 2.9 per cent and operational risk 3.9 per cent of the total risk-weighted assets. Tier 1 and total regulatory capital were US$2,410.9 million and US$2,563.5 million respectively.

At 31st December 2017, GIB's tier 1 and total capital adequacy ratios were 14.7 per cent and 15.6 per cent respectively. GIB aims to maintain a tier 1 capital adequacy ratio above 10.5 per cent and a total capital adequacy ratio in excess of 14.0 per cent.

GIB views the Pillar 3 disclosures as an important contribution to increased risk transparency within the banking industry, and particularly important during market conditions characterised by high uncertainty. In this regard, GIB has provided more disclosure in this report than is required in accordance with the CBB's Pillar 3 guidelines in order to provide the level of transparency that is believed to be appropriate and relevant to the Group's various stakeholders and market participants.

All figures presented in this report are as at 31st December 2017 unless otherwise stated.

Risk management and capital adequacy report (continued)

31st December 2017

1. The Basel 3 framework

The CBB's Basel 3 framework is based on three pillars, consistent with the Basel 3 framework developed by the Basel Committee, as follows:-

- Pillar 1: the calculation of the risk-weighted assets (RWAs) and capital requirement.
- Pillar 2: the supervisory review process, including the Internal Capital Adequacy Assessment Process (ICAAP).
- Pillar 3: the disclosure of risk management and capital adequacy information.

1.1 Pillar 1

Pillar 1 prescribes the basis for the calculation of the regulatory capital adequacy ratio. Pillar 1 sets out the definition and calculations of the RWAs, and the derivation of the regulatory capital base. The capital adequacy ratio is calculated by dividing the regulatory capital base by the total RWAs.

With the introduction of Pillar 2, the CBB will implement a minimum ratio threshold to be determined for each institution individually, as described in more detail in the Pillar 2 section of this report. As at 31st December 2017, and pending finalisation of the CBB's Pillar 2 guidelines, all banks incorporated in Bahrain are required to maintain a minimum capital adequacy ratio of 12.5 per cent and a tier 1 ratio of 10.5 per cent.

In the event that the capital adequacy ratio falls below 12.5 per cent, additional prudential reporting requirements apply and a formal action plan setting out the measures to be taken to restore the ratio above the target level is to be formulated and submitted to the CBB.

The table below summarises the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel 3 capital adequacy framework:-

Approaches for determining regulatory capital requirements		
Credit risk	**Market risk**	**Operational risk**
Standardised approach	Standardised approach	Basic indicator approach
	Internal models approach	Standardised approach

The approach applied by GIB for each risk type is as follows:-

a) Credit risk

For regulatory reporting purposes, GIB applies the standardised approach for credit risk.

The RWAs are determined by multiplying the credit exposure by a risk weight factor dependent on the type of counterparty and the counterparty's external rating, where available.

b) Market risk

For the regulatory market risk capital requirement, GIB applies the internal models approach based on a Value-at-Risk (VaR) model. The use of the internal models approach for the calculation of regulatory market risk capital has been approved by the CBB.

c) Operational risk

Under the CBB's Basel 3 capital adequacy framework, all banks incorporated in Bahrain are required to apply the basic indicator approach for operational risk unless approval is granted by the CBB to use the standardised approach. The CBB's Basel 3 guidelines do not permit the use of the advanced measurement approach (AMA) for operational risk. The standardised approach for the calculation of regulatory operational risk capital has been approved by the CBB.

Under the standardised approach, the regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines.

Risk management and capital adequacy report (continued)

31st December 2017

1. The Basel 3 framework (continued)

1.2 Pillar 2

Pillar 2 defines the process of supervisory review of an institution's risk management framework and, ultimately, its capital adequacy.

Under the CBB's Pillar 2 guidelines, each bank is to be individually assessed by the CBB and an individual minimum capital adequacy ratio is to be determined for each bank. The CBB is yet to undertake the assessment exercises, which will allow their setting of higher minimum capital ratios based on the CBB's assessment of the financial strength and risk management practices of the institution. Currently, pending finalisation of the assessment process, all banks incorporated in Bahrain are required to maintain a 12.5 per cent minimum capital adequacy ratio and a tier 1 ratio of 10.5 per cent.

Pillar 2 comprises two processes:-

- an Internal Capital Adequacy Assessment Process (ICAAP), and
- a supervisory review and evaluation process.

The ICAAP incorporates a review and evaluation of risk management and capital relative to the risks to which the bank is exposed. GIB's capital assessment has been developed around its economic capital framework which is designed to ensure that the Group has sufficient capital resources available to meet regulatory and internal capital requirements, even during periods of economic or financial stress. The capital assessment addresses all components of GIB's risk management, from the daily management of more material risks to the strategic capital management of the Group.

The supervisory review and evaluation process represents the CBB's review of the Group's capital management and an assessment of internal controls and corporate governance. The supervisory review and evaluation process is designed to ensure that institutions identify their material risks and allocate adequate capital, and employ sufficient management processes to support such risks.

The supervisory review and evaluation process also encourages institutions to develop and apply enhanced risk management techniques for the measurement and monitoring of risks in addition to the credit, market and operational risks addressed in the core Pillar 1 framework. Other risk types which are not covered by the minimum capital requirements in Pillar 1 include liquidity risk, interest rate risk in the banking book, business risk and concentration risk. These are covered either by capital, or risk management and mitigation processes under Pillar 2.

1.3 Pillar 3

In the CBB's Basel 3 framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

The disclosures comprise detailed qualitative and quantitative information. The purpose of the Pillar 3 disclosure requirements is to complement the first two pillars and the associated supervisory review process. The disclosures are designed to enable stakeholders and market participants to assess an institution's risk appetite and risk exposures and to encourage all banks, via market pressures, to move toward more advanced forms of risk management.

Under the current regulations, partial disclosure consisting mainly of quantitative analysis is required during half year reporting, whereas fuller disclosure is required to coincide with the financial year end reporting.

In this report, GIB's disclosures are beyond the minimum regulatory requirements and provide disclosure of the risks to which it is exposed, both on- and off-balance sheet. The disclosures in this report are in addition to the disclosures set out in the consolidated financial statements presented in accordance with International Financial Reporting Standards (IFRS).

2. Group structure, overall risk and capital management

This section sets out the consolidation principles and the capital base of GIB as calculated in accordance with the Pillar 1 guidelines, and describes the principles and policies applied in the management and control of risk and capital.

2.1 Group structure

The Group's financial statements are prepared and published on a full consolidation basis, with all subsidiaries being consolidated in accordance with IFRS. For capital adequacy purposes, all subsidiaries are included within the Gulf International Bank B.S.C. Group structure. However, the CBB's capital adequacy methodology accommodates both normal and aggregation forms of consolidation.

Risk management and capital adequacy report (continued)
31st December 2017

2. Group structure, overall risk and capital management (continued)

2.1 Group structure (continued)
Under the CBB capital adequacy framework, subsidiaries reporting under a Basel 3 framework in other regulatory jurisdictions may, at the bank's discretion, be consolidated based on that jurisdiction's Basel 3 framework, rather than based on the CBB's guidelines. Under this aggregation consolidation methodology, the risk-weighted assets of subsidiaries are consolidated with those of the rest of the Group based on the guidelines of their respective regulator to determine the Group's total risk-weighted assets.

GIB's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), is regulated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) of the United Kingdom, and has calculated its risk-weighted assets in accordance with the PRA's guidelines.

The principal subsidiaries and basis of consolidation for capital adequacy purposes are as follows:-

Subsidiary	Domicile	Ownership	Consolidation basis
Gulf International Bank (UK) Limited	United Kingdom	100%	Aggregation
GIB Capital C.J.S.C.	Saudi Arabia	100%	Full Consolidation
GIB Markets Limited	Cayman Islands	100%	Full Consolidation

No investments in subsidiaries are treated as a deduction from the Group's regulatory capital.

2.2 Risk and capital management
GIB 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 risk 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 has the ultimate responsibility for setting the overall risk parameters and tolerances within which the Group conducts its activities, including responsibility for setting the capital ratio targets. The Board 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 Group Chief Executive Officer (Group 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 in performing its risk related functions.

The Group Risk Committee, under the chairmanship of the Group Chief Risk Officer (Group CRO) and comprising the Group's most senior risk professionals, provides a forum for the review and approval of new products, risk measurement methodologies and risk control processes. The Group Risk Committee also reviews all risk policies and limits that require approval by the Management Committee. The Assets and Liabilities Committee (ALCO), chaired by the Group Chief Financial Officer (Group CFO), provides a forum for the review of asset and liability activities within GIB. It co-ordinates the asset and liability functions and serves as a link between the funding sources and usage in the different business areas.

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 Credit Risk, Market Risk, Operational Risk, 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.

Internal Audit is responsible for carrying out a risk-based programme of work designed to provide assurance that assets are being safeguarded. This involves ensuring that controls are in place and working effectively in accordance with Group policies and procedures as well as with laws and regulations. The work carried out by Internal Audit includes providing assurance on the effectiveness of the risk management functions, as well as that of controls operated by the business units. The Board Audit Committee approves the annual audit plan and also receives regular reports of the results of audit work.

Risk management and capital adequacy report (continued)

31st December 2017

2. Group structure, overall risk and capital management (continued)

2.2 Risk and capital management (continued)

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future business development. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout or the issue of new shares.

The Group CFO is responsible for the capital planning process. Capital planning includes capital adequacy reporting, economic capital and parameter estimation, i.e. probability of default (PD) and loss given default (LGD) estimates, used for the calculation of economic capital. The Group CFO is also responsible for the balance sheet management framework.

The governance structure for risk and capital management is set out in the table below:-

Board of Directors		
Board Audit Committee	Board Risk Policy Committee	
Chief Executive Officer		
Management Committee (Chairman: Group CEO)	Group Risk Committee (Chairman: Group CRO)	Assets and Liabilities Committee (Chairman: Group CFO)

The risk, liquidity and capital management responsibilities are set out in the table below:-

Chief Executive Officer	
Chief Financial Officer (Group CFO)	**Chief Risk Officer (Group CRO)**
Balance sheet management framework Capital management framework	Risk management framework and policies Group credit control Credit risk Market risk Operational risk Liquidity risk

2.3 Risk types

The major risks associated with the Group's business activities are credit, market, operational and liquidity risk. These risks together with a commentary on the way in which the risks are managed and controlled are set out in the following sections, based on the Basel 3 pillar in which the risks are addressed.

2.4 Risk in Pillar 1

Pillar 1, which forms the basis for the calculation of the regulatory capital requirement, addresses three specific risk types: credit, market and operational risk.

a) 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 the offsetting of receivables and payables
- obtaining collateral
- seeking third party guarantees of the counterparty's obligations
- imposing restrictions and covenants on borrowers

Risk management and capital adequacy report (continued)

31st December 2017

2. Group structure, overall risk and capital management (continued)

2.4 Risk in Pillar 1 (continued)

a) Credit risk (continued)

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 undertaken 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 counterparty, which affects the credit approval decision and the terms and conditions of the transaction. For cross-border transactions, an analysis of country risk is also conducted. The credit decision for an individual counterparty is based 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 Group Chief Risk Officer (Group CRO), Group Chief Credit Officer (Group CCO) and other members of senior management. 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 principally utilises derivative transactions 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 Group seeks to minimise these risks by the use of standard contract agreements.

b) 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 adverse changes in market prices and rates, and market conditions such as liquidity. Market risk arises from the Group's trading, asset and liability management, and investment activities.

The categories of market risk to which the Group is exposed are as follows:-

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 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. The principal foreign exchange risk arises from the Group's foreign exchange forward and derivative trading activities.

Equity risk arises from exposures to changes in the price and volatility of individual equities or equity indices.

The Group seeks to manage exposure to market risk through the diversification of exposures across dissimilar markets and the 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 judgement 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 VaR is derived from quantitative models that use statistical and simulation methods that take account of all market rates and prices that may cause a change in a position's value. These include interest rates, foreign exchange rates and equity prices, their respective volatilities and the correlations between these variables. The Group's VaR is calculated on a Monte Carlo simulation basis using historical volatilities and correlations to generate a profit and loss distribution from several thousand scenarios.

Risk management and capital adequacy report (continued)

31st December 2017

2. Group structure, overall risk and capital management (continued)

2.4 Risk in Pillar 1 (continued)

b) Market risk (continued)

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 suitable proxies. 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 measurement 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.

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 regularly conducted to estimate the potential economic losses in such abnormal markets. 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 1998 Russian crisis, the events of 9/11 and the 2008 credit crisis. 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.

c) 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 potential 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.

Operational risk is a distinct risk category which the Group manages within acceptable levels through sound operational risk management practices that are part of the day-to-day responsibilities of management at all levels. 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 objective in managing operational risk is to ensure control of the Group's resources by protecting the assets of the Group and minimising the potential for financial loss. The Group's risk management approach involves identifying, assessing, managing, mitigating, monitoring and measuring the risks associated with all areas of the Group. Control assessments are performed on all services of the Group with the participation of representatives from the relevant businesses, internal audit, legal and the risk and finance departments. Various policies, procedures and processes are used to manage operational risk and include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, appropriate budgeting, target setting and performance review, compliance to regulations, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, policies have been put in place to manage other control mitigation strategies for business continuity planning, insurance and legal risk (which includes regular reporting to management on legal matters).

Qualitative and quantitative methodologies and tools are used to identify and assess operational risk and to provide management with information for determining appropriate mitigating factors. These tools include a database of operational risk events categorised according to business lines and operational risk event types; a record of key risk indicators, which can provide an early warning of possible risk; and a risk and control assessment process to analyse business activities and identify operational risks related to those activities. The management of operational risk has a key objective of minimising the impact of losses suffered in the normal course of business (expected losses) and to avoid or reduce the likelihood of suffering a large extreme (unexpected) loss. There is a dedicated Operational Risk function for the Group which reports into the Operational Risk Management Committee and Group Risk Committee. The Board meets on a quarterly basis and is updated on all relevant aspects of the business including operational risk management matters. High impact risks and issues of critical importance are reported to the Board.

Risk management and capital adequacy report (continued)
31st December 2017

2. Group structure, overall risk and capital management (continued)

2.5 Risk in Pillar 2
Other risk types are measured and assessed in Pillar 2. GIB measures and manages these risk types although they are not included in the calculation of the regulatory capital adequacy ratio. Most of the Pillar 2 risks are included in GIB's calculation of internal economic capital. Pillar 2 risk types include liquidity risk, interest rate risk in the banking book, business risk and concentration risk.

a) Liquidity risk
Liquidity risk is the risk that sufficient funds are not available to meet the Group's financial obligations on a punctual basis as they fall due. The risk arises from the timing differences between the maturity profiles of the Group's assets and liabilities. It includes the risk of losses arising from the following:-

- forced sale of assets at below normal market prices
- raising of deposits or borrowing funds at excessive rates
- the investment of surplus funds at below market rates

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 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.

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within approved limits. The limits ensure that contractual net cash flows occurring over the following 30 day period do not exceed the eligible stock of available liquid resources.

It is the Group's general policy that each geographic entity should be self-sufficient in relation to funding its own operations.

The Group's liquidity management policies include the following:-

- the monitoring of (i) future contractual cash flows against approved limits, and (ii) the level of liquid resources available in a stress event
- the monitoring of balance sheet liquidity ratios
- the monitoring of the sources of funding in order to ensure that funding is derived from a diversified range of sources
- the monitoring of depositor concentrations in order to avoid undue reliance on individual depositors
- the maintenance of a satisfactory level of term financing
- the maintenance of appropriate standby funding arrangements; and
- the maintenance of liquidity and funding contingency plans. These plans identify early indicators of stress conditions and prescribe the actions to be taken in the event of a systemic or other crisis, while minimising adverse long-term implications for the Group's business activities.

b) Interest rate risk in the banking book
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.

c) Business risk
Business risk represents the earnings volatility inherent in all businesses due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated based on the observed volatility in historical profits and losses.

Risk management and capital adequacy report (continued)
31st December 2017

2. Group structure, overall risk and capital management (continued)

2.5 Risk in Pillar 2 (continued)

d) Concentration risk

Concentration risk is the risk related to the degree of diversification in the credit portfolio, i.e. the risk inherent in doing business with large customers or not being equally exposed across industries and regions.

Concentration risk is captured in GIB's economic capital framework through the use of a credit risk portfolio model which considers single-name concentrations in the credit portfolio. Economic capital add-ons are applied where counterparty exposures exceed specified thresholds.

Potential concentration risks by product, industry, single obligor, and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by senior management and the Board of Directors.

2.6 Monitoring and reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, and on a monthly or quarterly basis for credit and operational risk.

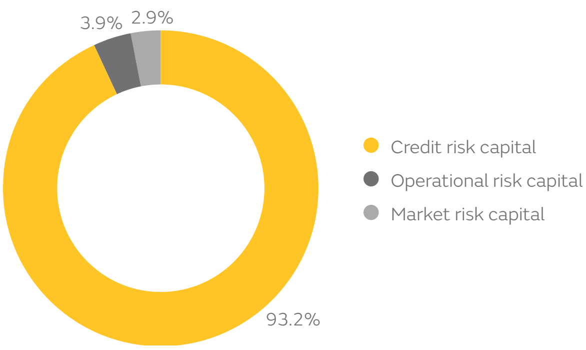
Risk reporting is regularly made to senior management and the Board of Directors. The Board of Directors receives internal risk reports covering market, credit, operational and liquidity risks.

Capital management, including regulatory and internal economic capital ratios, is reported to senior management and the Board of Directors on a monthly basis.

3. Regulatory capital requirements and the capital base

This section describes the Group's regulatory capital requirements and capital base.

The composition of the total regulatory capital requirement was as follows:-



3.1 Capital requirements for credit risk

For regulatory reporting purposes, GIB calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach, on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. The exposure categories are referred to in the CBB's Basel 3 capital adequacy framework as standard portfolios. The primary standard portfolios are claims on sovereigns, claims on banks and claims on corporates. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk-weightings. Under the standardised approach, the risk-weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBB. GIB uses ratings assigned by Standard & Poor's, Moody's and Fitch.

Risk management and capital adequacy report (continued)

31st December 2017

3. Regulatory capital requirements and the capital base (continued)

3.1 Capital requirements for credit risk (continued)

An overview of the exposures, RWAs and capital requirements for credit risk analysed by standard portfolio is presented in the table below:-

	Rated exposure	Unrated exposure	Total exposure	Average risk weight	RWA	Capital requirement
	US$ millions	US$ millions	US$ millions	%	US$ millions	US$ millions
Sovereigns	7,657.8	-	7,657.8	3%	243.8	30.5
PSEs	547.3	-	547.3	4%	20.1	2.5
Banks	7,146.1	-	7,146.1	29%	2,052.0	256.5
Corporates	1,464.2	11,201.9	12,666.1	93%	11,827.6	1,478.5
Equities	-	232.8	232.8	126%	292.7	36.6
Past due loans	-	209.4	209.4	129%	270.8	33.9
Other assets	39.4	542.4	581.8	101%	587.1	73.4
	16,854.8	**12,186.5**	**29,041.3**	**53%**	**15,294.1**	**1,911.9**

Exposures are stated after taking account of credit risk mitigants where applicable. The treatment of credit risk mitigation is explained in more detail in section 4.4(g) of this report.

The definitions of each standard portfolio and the related RWA requirements are set out in section 4 of this report.

3.2 Capital requirements for market risk

GIB uses a Value-at-Risk (VaR) model to calculate the regulatory capital requirements relating to general market risk.

The VaR calculated by the internal model is subject to a multiplication factor determined by the CBB. GIB's multiplication factor has been set at the regulatory minimum of 3.0 by the CBB.

Prescribed additions in respect of specific risk are made to general market risk. The resultant measure of market risk is multiplied by 12.5, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The RWAs and capital requirements for market risk are presented in the table below:-

	RWA	Capital requirement
	US$ millions	US$ millions
Interest rate risk	142.3	17.8
Equities	226.5	28.3
Foreign exchange risk	10.8	1.4
Total general market risk	379.6	47.5
Total specific market risk	90.6	11.3
	470.2	**58.8**

The general market risk calculation includes the addition of stressed VaR in accordance with CBB guidelines.

3.3 Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated in accordance with the standardised approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a range of beta coefficients. The beta coefficients are determined based on the business line generating the gross income and are prescribed in the CBB's Basel 3 capital adequacy framework and range from 12 to 18 per cent.

The capital requirement for operational risk at 31st December 2017 amounted to US$80.7 million.

Risk management and capital adequacy report (continued)
31st December 2017

3. Regulatory capital requirements and the capital base (continued)

3.4 Capital base
The regulatory capital base is set out in the table below:-

	CET 1 & Tier 1	Tier 2	Total
	US$ millions	US$ millions	US$ millions
Share capital	2,500.0	-	2,500.0
Share premium	7.6	-	7.6
Compulsory reserve	225.8	-	225.8
Voluntary reserve	163.3	-	163.3
Retained earnings	(441.6)	-	(441.6)
Unrealised losses from fair valuing equity investments	(43.7)	-	(43.7)
Cash flow hedge reserve	(0.5)	-	(0.5)
Collective loan impairment provisions	-	152.6	152.6
Tier 1 and tier 2 capital base	**2,410.9**	**152.6**	**2,563.5**

Common equity tier 1 (CET 1) and tier 1 capital is defined as capital of the same or close to the character of paid up capital and comprises share capital, share premium, retained earnings and eligible reserves. Eligible reserves exclude revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions, although include unrealised gains and losses arising on the remeasurement to fair value of equity investment securities classified as fair value through other comprehensive income (FVTOCI). Regulatory capital deductions are applied to tier 1 and tier 2 capital with respect to investment exposures for entities where the Group does not own more than 10 per cent of the issued share capital of the entity, and to tier 1 capital to exclude any outstanding cash flow hedge reserves.

Tier 2 capital comprises collective loan impairment provisions.

The CBB applies various limits to elements of the regulatory capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier 1 capital. There are also restrictions on the amount of collective impairment provisions that may be included as part of tier 2 capital.

There are no impediments on the transfer of funds or regulatory capital within the Group other than restrictions over transfers of statutory deposits with central banks and safeguards to ensure minimum regulatory capital requirements are met for subsidiary companies.

4. Credit risk – Pillar 3 disclosures
This section describes the Group's exposure to credit risk and provides detailed disclosures on credit risk in accordance with the CBB's Basel 3 framework in relation to Pillar 3 disclosure requirements.

4.1 Definition of exposure classes
GIB has a diversified on- and off-balance sheet credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel 3 capital adequacy framework for the standardised approach for credit risk. A high-level description of the counterparty exposure classes, referred to as standard portfolios in the CBB's Basel 3 capital adequacy framework, and the generic treatments, i.e. the risk weights to be used to derive the RWAs, are as follows:-

Sovereigns portfolio
The sovereigns portfolio comprises exposures to governments and their respective central banks. The risk weights are 0 per cent for exposures in the relevant domestic currency, or in any currency for exposures to GCC governments. Foreign currency claims on other sovereigns are risk-weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereigns portfolio and treated as exposures with a 0 per cent risk-weighting.

Risk management and capital adequacy report (continued)
31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.1 Definition of exposure classes (continued)

PSE portfolio
Public sector entities (PSEs) are risk-weighted according to their external ratings with the exception of Bahrain PSEs, and domestic currency claims on other PSEs which are assigned a 0 per cent risk weight by their respective country regulator.

Banks portfolio
Claims on banks are risk-weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short-term exposures. Short-term exposures are defined as exposures with an original tenor of three months or less.

The Banks portfolio also includes claims on investment firms, which are risk-weighted based on their external credit ratings although without any option for preferential treatment for short-term exposures. A regulatory deduction is applied to investment exposures for entities where the Group does not own more than 10 per cent of the issued share capital of the bank.

Corporates portfolio
Claims on corporates are risk-weighted based on their external credit ratings. A 100 per cent risk weight is assigned to unrated corporate exposures. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a 0 per cent risk weight.

Equities portfolio
The equities portfolio comprises equity investments in the banking book, i.e. in the investment securities portfolio and non-qualifying equities and funds in the trading portfolio. The credit (specific) risk for qualifying equities in the trading book is included in market risk RWAs for regulatory capital adequacy calculation purposes. A regulatory deduction is applied to investment exposures for entities where the Group does not own more than 10 per cent of the issued share capital of the entity.

A 100 per cent risk weight is assigned to listed equities and funds. Unlisted equities and funds are risk-weighted at 150 per cent. Investments in rated funds are risk-weighted according to their external credit rating.

In addition to the standard portfolios, other exposures are assigned to the following exposure classes:-

Past due exposures
All past due loan exposures, irrespective of the categorisation of the exposure if it were performing, are classified separately under the past due exposures asset class. A risk-weighting of either 100 per cent or 150 per cent is applied depending on the level of provision maintained against the loan.

Other assets and holdings of securitisation tranches
Cash balances are risk-weighted at 0 per cent, other assets are risk-weighted at 100 per cent. A credit valuation adjustment (CVA) is applied to applicable derivative exposures.

Securitisation tranches are risk-weighted based on their external credit ratings and tenor. Risk-weightings range from 20 per cent to 1,250 per cent.

4.2 External rating agencies
GIB uses ratings issued by Standard & Poor’s, Moody’s and Fitch to derive the risk-weightings under the CBB’s Basel 3 capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to derive the risk-weightings for regulatory capital adequacy purposes.

Risk management and capital adequacy report (continued)

31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.3 Credit risk presentation under Basel 3

The credit risk exposures presented in this report may differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:-

- Under the CBB's Basel 3 framework, off-balance sheet exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off-balance sheet exposure is multiplied by the relevant CCF applicable to the off-balance sheet exposure category. Subsequently, the exposure is treated in accordance with the standard portfolios referred to in section 4.1 of this report in the same manner as on-balance sheet exposures.

- Credit risk exposure reporting under Pillar 3 is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Banks standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.

- Certain eligible collateral is applied to reduce exposure under the Basel 3 capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.

- Based on the CBB's Basel 3 guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements.

- Under the CBB's Basel 3 capital adequacy framework, external rating agency ratings are based on the highest rating from the lowest two ratings, while for internal credit risk management purposes the Group uses the lowest rating.

4.4 Credit exposure

a) Gross credit exposure

The gross and average gross exposure to credit risk before applying collateral, guarantees, and other credit enhancements was as follows:-

	Gross credit exposure	Average gross credit exposure
	US$ millions	**US$ millions**
Balance sheet items:		
Cash and other liquid assets (including cash balances)	3,768.5	4,744.8
Securities purchased under agreements to resell	855.0	735.8
Placements	6,033.2	5,168.7
Trading securities	191.8	162.8
Investment securities	3,993.8	3,922.6
Loans and advances	10,043.1	10,310.9
Accrued interest and fees receivable	214.7	206.5
Total on-balance sheet credit exposure	**25,100.1**	**25,252.1**
Off-balance sheet items:		
Credit-related contingent items	5,027.9	4,477.6
Derivative and foreign exchange instruments	203.3	228.3
Total off-balance sheet credit exposure	**5,231.2**	**4,705.9**
Total gross credit exposure	**30,331.3**	**29,958.0**

The average gross credit exposure is based on monthly averages during the year ended 31st December 2017.

Risk management and capital adequacy report (continued)
31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

a) Gross credit exposure (continued)

The gross credit exposure for derivative and foreign exchange instruments is the replacement cost (current exposure) representing the cost of replacing the contracts at current market rates should the counterparty default prior to the settlement date. The gross credit exposure reported in the table above does not include potential future exposure. Further details on the counterparty credit risk relating to off-balance sheet exposures are set out in section 7.3(a) of this report.

b) Credit exposure by geography

The classification of credit exposure by geography, based on the location of the counterparty, was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Accrued interest-fees receivable	Off-balance sheet items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
GCC	3,481.2	2,386.8	9,828.8	118.7	4,458.0	20,273.5
Europe	5,657.5	670.3	160.3	82.6	395.6	6,966.3
North America	1,104.6	587.7	29.6	8.4	335.0	2,065.3
Asia	393.4	518.4	18.1	4.7	41.7	976.3
MENA (excluding GCC)	20.0	2.7	6.3	0.3	0.9	30.2
Latin America	-	19.7	-	-	-	19.7
	10,656.7	**4,185.6**	**10,043.1**	**214.7**	**5,231.2**	**30,331.3**

The MENA region comprises the Middle East and North Africa.

c) Credit exposure by industrial sector

The classification of credit exposure by industrial sector was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Accrued interest-fees receivable	Off-balance sheet items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Financial services	5,486.6	698.1	2,043.6	141.8	750.8	9,120.9
Government	5,170.1	2,180.5	111.3	19.7	20.5	7,502.1
Energy, oil and petrochemical	-	447.4	1,678.7	12.2	1,018.6	3,156.9
Trading and services	-	6.9	2,178.3	8.4	471.1	2,664.7
Construction	-	10.7	660.2	3.3	1,654.5	2,328.7
Manufacturing	-	269.5	1,101.1	8.0	327.8	1,706.4
Transportation	-	101.7	1,351.2	6.3	137.4	1,596.6
Agriculture and mining	-	-	233.9	0.7	439.1	673.7
Real estate	-	92.2	307.4	5.0	84.6	489.2
Equity investments	-	349.5	-	3.7	3.2	356.4
Communication	-	-	211.3	0.7	13.3	225.3
Other	-	29.1	166.1	4.9	310.3	510.4
	10,656.7	**4,185.6**	**10,043.1**	**214.7**	**5,231.2**	**30,331.3**

Risk management and capital adequacy report (continued)

31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

d) Credit exposure by internal rating

The credit risk profile based on internal credit ratings and presented based on the International Financial Reporting Standards (IFRS) 9 – Financial Instruments classification was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Accrued interest-fees receivable	Off-balance sheet items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Stage 1						
Rating grades 1 to 4-	10,533.0	3,606.8	5,945.7	182.7	3,345.6	23,613.8
Rating grades 5+ to 5-	99.1	229.3	3,064.2	23.0	658.4	4,074.0
Rating grades 6+ to 6-	24.6	-	114.4	0.4	63.2	202.6
Rating grade 7	-	-	0.2	-	-	0.2
Equity investments	-	349.5	-	3.7	3.2	356.4
Carrying amount (net)	10,656.7	4,185.6	9,124.5	209.8	4,070.4	28,247.0
Stage 2						
Rating grades 1 to 4-	-	-	10.7	0.2	0.3	11.2
Rating grades 5+ to 5-	-	-	363.9	2.5	80.4	446.8
Rating grades 6+ to 6-	-	-	321.4	2.1	1,014.5	1,338.0
Rating grade 7	-	-	103.8	0.1	-	103.9
Carrying amount (net)	-	-	799.8	4.9	1,095.2	1,899.9
Stage 3						
Rating grade 8	-	-	90.0	-	52.9	142.9
Rating grade 9	-	-	28.8	-	12.3	41.1
Rating grade 10	-	-	-	-	0.4	0.4
Carrying amount (net)	-	-	118.8	-	65.6	184.4
	10,656.7	**4,185.6**	**10,043.1**	**214.7**	**5,231.2**	**30,331.3**

The above analysis is reported net of the following provisions for impairment:

Stage 1	-	(4.5)	(46.3)	-	-	(50.8)
Stage 2	-	-	(106.3)	-	-	(106.3)
Stage 3	-	-	(261.0)	-	-	(261.0)
	-	**(4.5)**	**(413.6)**	**-**	**-**	**(418.1)**

Following the adoption of IFRS 9 – Financial Instruments, the Group has classified credit exposures in the following prescribed stages:-

- Stage 1: for financial instruments where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the Group recognises an allowance based on 12-month expected credit losses.
- Stage 2: for financial instruments where there has been a significant increase in credit risk since initial recognition but they are not credit-impaired, the Group recognises an allowance for the lifetime expected credit losses.
- Stage 3: for credit-impaired financial instruments, the Group recognises the lifetime expected credit losses.

The analysis is presented prior to the application of credit risk mitigation techniques.

The Group's internal credit rating system is commented on in more detail in section 8.1 of this report.

Risk management and capital adequacy report (continued)

31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

e) Credit exposure by maturity

The maturity profile of funded credit exposures based on contractual maturity dates was as follows:-

	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Accrued interest-fees receivable	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Within 3 months	9,348.3	319.9	3,357.0	178.8	13,204.0
4 months to 1 year	954.9	357.2	2,527.1	35.9	3,875.1
Years 2 to 5	340.1	1,555.5	3,147.5	-	5,043.1
Years 6 to 10	-	1,435.9	717.8	-	2,153.7
Years 11 to 20	-	172.1	103.6	-	275.7
Over 20 years and other	13.4	345.0	190.1	-	548.5
	10,656.7	**4,185.6**	**10,043.1**	**214.7**	**25,100.1**

An analysis of off-balance sheet exposure is set out in section 7 of this report.

Securities exposure over 20 years comprises equity investments and the securities non-specific provision.

Placements, reverse repos & other liquid assets exposure over 20 years comprises cash in hand.

f) Equities held in the banking book

Equity investments included in investment securities in the consolidated balance sheet are included in the equities standard portfolio in the Pillar 1 credit risk capital adequacy framework. Such equity investment securities principally comprise listed equities received in settlement of a past due loan, investments of a private equity nature, and investments in funds managed by specialist managers.

At 31st December 2017, equity investment securities held in the banking book amounted to US$170.7 million, of which US$100.8 million comprised listed equities received in settlement of a secured past due loan and US$13.7 million comprised managed funds.

During the year ended 31st December 2017, US$1.4 million of gains were realised on equity investments. At 31st December 2017, net unrealised losses on equity investment securities amounted to US$43.7 million and are included as a deduction from tier 1 capital.

g) Credit risk mitigation

The credit exposure information presented in section 4 of this report represents gross exposures prior to the application of any credit risk mitigants. Collateral items and guarantees which can be used for credit risk mitigation under the capital adequacy framework are referred to as eligible collateral. Only certain types of collateral and some issuers of guarantees are eligible for preferential risk weights for regulatory capital adequacy purposes. Furthermore, the collateral management process and the terms in the collateral agreements have to fulfil the CBB's prescribed minimum requirements (such as procedures for the monitoring of market values, insurance and legal certainty) set out in their capital adequacy regulations.

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as follows:-

- Adjusted exposure amount: GIB uses the comprehensive method for financial collateral such as cash, bonds and shares. The exposure amount is adjusted with regard to the financial collateral. The size of the adjustment depends on the volatility of the collateral and the exposure. GIB uses volatility adjustments specified by the CBB, known as supervisory haircuts, to reduce the benefit of collateral and to increase the magnitude of the exposure.

Risk management and capital adequacy report (continued)
31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

g) Credit risk mitigation (continued)

- Substitution of counterparty: The substitution method is used for guarantees, whereby the rating of the counterparty is substituted with the rating of the guarantor. This means that the credit risk in respect of the counterparty is substituted by the credit risk of the guarantor and the capital requirement is thereby reduced. Hence, a fully guaranteed exposure will be assigned the same capital treatment as if the exposure was to the guarantor rather than to the counterparty.

Description of the main types of credit risk mitigation

GIB uses a variety of credit risk mitigation techniques in several different markets which contribute to risk diversification and credit protection. The different credit risk mitigation techniques such as collateral, guarantees, credit derivatives, netting agreements and covenants are used to reduce credit risk. All credit risk mitigation activities are not necessarily recognised for capital adequacy purposes as they are not defined as eligible under the CBB's Basel 3 capital adequacy framework, e.g. covenants and non-eligible tangible collateral such as unquoted equities. The recognised credit risk mitigation activities are undertaken with various counterparties to ensure no additional credit or market risk concentrations occur.

Exposures secured by eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio were as follows:-

	Exposure before credit risk mitigation	Eligible collateral	Of which secured by: Eligible guarantees or credit derivatives
	US$ millions	US$ millions	US$ millions
Sovereigns	62.5	-	62.5
Banks	2,726.9	2,194.2	325.4
Corporates	324.2	62.7	-

Guarantees and credit derivatives

Only eligible providers of guarantees and credit derivatives may be recognised in the standardised approach for credit risk. Guarantees issued by corporate entities may only be taken into account if their rating corresponds to A- or higher. The guaranteed exposures receive the risk weight of the guarantor.

GIB uses credit derivatives as credit risk protection only to a limited extent as the credit portfolio is considered to be well diversified.

Collateral and valuation principles

The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market/ fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the facility agreements. In general, lending is based on the customer's repayment capacity rather than the collateral value. However, collateral is considered the secondary alternative if the repayment capacity proves inadequate. Collateral is not usually held against securities or placements.

Types of eligible collateral commonly accepted

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees.

4.5 Impaired credit facilities and provisions for impairment

Individually impaired financial assets represent assets for which 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 obligation. Objective evidence that a financial asset is impaired may include: a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial re-organisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group.

Risk management and capital adequacy report (continued)
31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.5 Impaired credit facilities and provisions for impairment (continued)

Provisions for impairment are determined based on the difference between the net carrying amount and the recoverable amount of a financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral.

Provisions for impairment are also measured and recognised on a collective basis in respect of expected credit losses and are classified as either stage 1 or stage 2, in accordance with IFRS 9.

The stage 1 and stage 2 provisions reflect the probability-weighted estimate of expected credit losses. The provisions comprise both quantitative and qualitative information and analysis, based on the Group's historical experience and taking into consideration both internal and external indicators and includes forward-looking information.

Provisions for impairment are recognised in the consolidated statement of income and are reflected in an allowance account against loans and advances, investment securities and placements.

a) Impaired loan facilities and related provisions for impairment

Impaired loan facilities and the related provisions for impairment were as follows:-

	Gross exposure	Impairment provisions	Net exposure
	US$ millions	US$ millions	US$ millions
Corporates	373.0	256.0	117.0
Financial sector	6.8	5.0	1.8
	379.8	**261.0**	**118.8**

The impaired loan facilities were principally to counterparties in the GCC.

b) Provisions for impairment – loans and advances

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

	Specific provisions	Collective provisions		
	Stage 3	Stage 1	Stage 2	Total
	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January	255.5	82.5	83.0	**421.0**
Transfer to stage 1	-	2.7	(2.7)	**-**
Transfer to stage 2	-	(13.9)	13.9	**-**
Transfer to stage 3	4.0	(1.1)	(2.9)	**-**
Amounts utilised	(51.2)	-	-	**(51.2)**
Exchange rate movements	0.1	-	-	**0.1**
Net remeasurement of loss allowance	52.6	(23.9)	15.0	**43.7**
At 31st December	**261.0**	**46.3**	**106.3**	**413.6**

Amounts utilised during the year ended 31st December 2017 represented provisions utilised on the transfer of the related loans to the memorandum records. Recovery efforts on these loans are still ongoing with the intention to maximise potential recoveries.

c) Impaired investment securities and related provisions for impairment

There were no impaired debt investment securities at 31st December 2017.

Risk management and capital adequacy report (continued)

31st December 2017

4. Credit risk – Pillar 3 disclosures (continued)

4.5 Impaired credit facilities and provisions for impairment (continued)

d) Provisions for impairment – investment securities

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

	Specific provisions	Collective provisions		
	Stage 3	Stage 1	Stage 2	Total
	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January and 31st December 2017	**-**	**4.5**	**-**	**4.5**

At 31st December 2017, the provisions for the impairment of investment securities entirely comprised non-specific provisions for debt investment securities determined on a collective basis.

4.6 Past due facilities

In accordance with guidelines issued by the CBB, credit facilities are placed on non-accrual status and interest income suspended when either principal or interest is overdue by 90 days whereupon unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities classified as past due are assessed for impairment in accordance with the IFRS guidelines as set out in section 4.5 of this report. A specific provision is established only where there is objective evidence that a credit facility is impaired.

a) Loans

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

	Gross	Carrying amount
	US$ millions	US$ millions
Corporates	454.2	198.6
Financial sector	25.2	20.2
	479.4	**218.8**

The past due loan facilities were principally to counterparties in the GCC.

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

	Less than 1 year	Years 2 and 3	Over 3 years	Total
	US$ millions	US$ millions	US$ millions	US$ millions
Corporates	170.2	121.7	162.3	454.2
Financial sector	18.2	-	7.0	25.2
	188.4	**121.7**	**169.3**	**479.4**

b) Investment securities

There were no debt investment securities for which either principal or interest was over 90 days past due.

Risk management and capital adequacy report (continued)

31st December 2017

5. Market risk – Pillar 3 disclosures

5.1 Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, commodity prices, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk and foreign exchange 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.

The Group's trading and foreign exchange activities principally comprise trading in debt securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate and foreign exchange 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.

5.2 VaR model

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. Exposure to general market risk is calculated utilising a VaR model. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the CBB. The multiplication factor to be applied to the VaR calculated by the internal model has been set at the regulatory minimum of 3.0 by the CBB.

From April 2012, the CBB has required that the VaR used for regulatory capital adequacy purposes incorporate a stressed VaR measure. This measure is intended to replicate the VaR for the Group's market risk exposures during periods of stress. The stressed VaR is increased by the multiplication factor and then added to the actual VaR to determine the regulatory capital requirement for market risk.

A key 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 manage the risk associated with fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile of the various asset and liability categories is set out in section 8.2(c) of this report.

For internal risk management purposes, the Group measures losses that are anticipated to occur within a 95 per cent confidence level. Internally, the Group measures VaR utilising a one-month assumed holding period for both trading and banking book positions. For regulatory capital adequacy purposes, the figures are calculated using the regulatory VaR basis at a 99 per cent confidence level (2.33 standard deviations) and a ten-day holding period using one-year unweighted historical daily movements in market rates and prices. Correlations across broad risk categories are excluded for regulatory capital adequacy purposes.

The VaR for the Group's trading positions as calculated in accordance with the regulatory parameters set out above, was as follows:-

	31.12.17	**Average**	**High**	**Low**
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**
Total VaR	1.8	1.8	2.5	0.1
Total undiversified stressed VaR	5.1	4.1	5.3	0.3

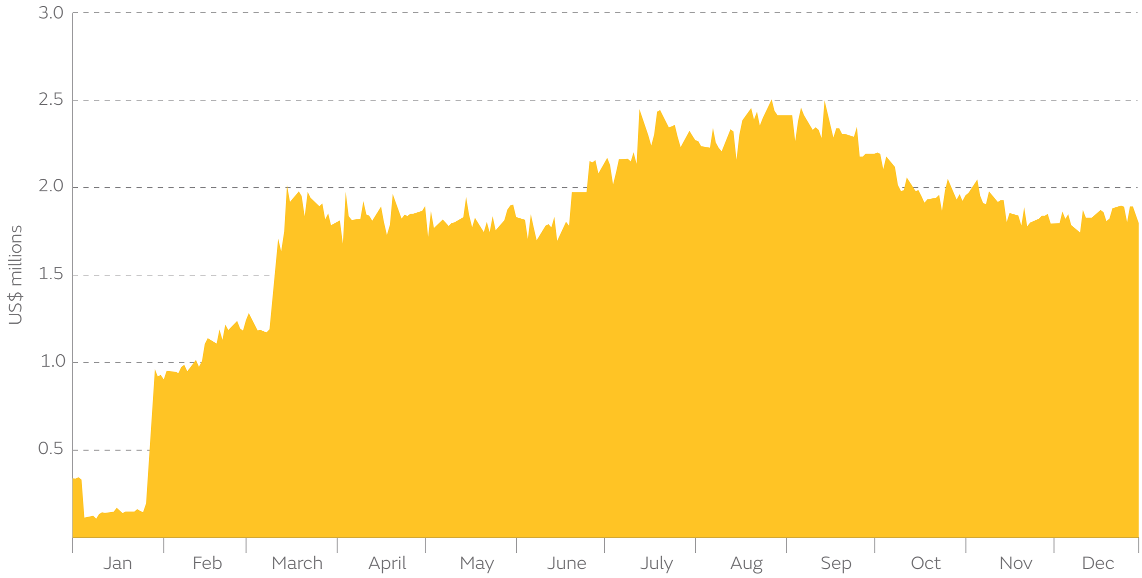
Risk management and capital adequacy report (continued)
31st December 2017

5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)

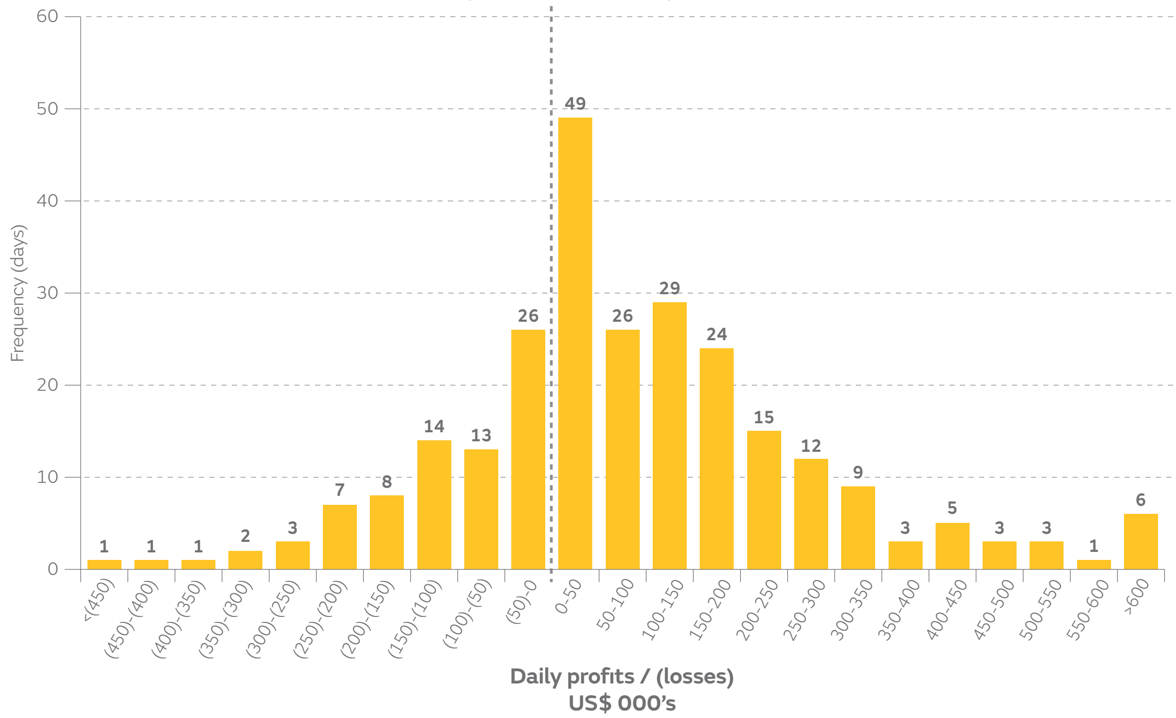
The graph below sets out the total VaR for all the Group's trading activities at the close of each business day throughout the year ended 31st December 2017:-

Trading Value-at-Risk daily development



The daily trading profits and losses during the year ended 31st December 2017 are summarised as follows:-

Histogram of daily trading profits & losses



The Group conducts daily VaR back testing both for regulatory compliance purposes and for the internal evaluation of VaR against actual trading profits and losses. During the year ended 31st December 2017, there were no instances of a daily trading loss exceeding the trading VaR at the close of business on the previous business day.

Risk management and capital adequacy report (continued)
31st December 2017

5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)
The five largest daily trading losses during the year ended 31st December 2017 compared to the 1-day VaR at the close of business on the previous business day were as follows:-

	Daily trading losses	1-day VaR
	US$ thousands	US$ thousands
4th July	620	676
11th October	422	639
20th June	377	561
5th May	335	579
9th October	333	688

5.3 Sensitivity analysis
The sensitivity of the interest rate risk in the banking book to changes in interest rates is set out in section 8.2(c) of this report.

The Group's investment debt securities are measured at amortised cost. However, the Group nevertheless monitors the impact of changes in credit spreads on the fair value of the debt securities.

6. Operational risk – Pillar 3 disclosures

6.1 Operational risk
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.

As part of the Group's Operational Risk Management Framework (ORMF), comprehensive risk self-assessments are conducted, which identify the operational risks inherent in the Group's activities, processes and systems. The controls in place to mitigate these risks are also reviewed, and enhanced as necessary. A database of measurable operational risk events is maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk.

The Group has an independent operational risk function. As part of the Group's Operational Risk Management Framework (ORMF), comprehensive risk assessments are conducted, which identify operational risks inherent in the Group's activities, processes and systems. The controls in place to mitigate these risks are also reviewed, and enhanced if necessary.

The capital requirement for operational risk is calculated for regulatory purposes according to the standardised approach, in which the regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines. Consequently, the operational risk capital requirement is updated only on an annual basis.

7. Off-balance sheet exposure and securitisations
Off-balance sheet exposures are divided into two exposure types in accordance with the calculation of credit risk RWAs in the CBB's Basel 3 capital adequacy framework:-

- Credit-related contingent items: Credit-related contingent items comprise guarantees, credit commitments and unutilised approved credit facilities

- Derivative and foreign exchange instruments: Derivative and foreign exchange 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 credit markets

Risk management and capital adequacy report (continued)

31st December 2017

7. Off-balance sheet exposure and securitisations (continued)

In addition to counterparty credit risk measured within the Basel 3 credit risk framework, derivatives also incorporate exposure to market risk and carry a potential market risk capital requirement, as commented on in more detail in section 5 of this report. A credit valuation adjustment (CVA) is applied to the relevant derivative exposure RWA's.

For the two off-balance exposure types, there are different possible values for the calculation base of the regulatory capital requirement, as commented on below:-

7.1 Credit-related contingent items

For credit-related contingent items, the notional principal amount is converted to an exposure at default (EAD) through the application of a credit conversion factor (CCF). The CCF factors range from 20 per cent to 100 per cent depending on the type of contingent item, and is intended to convert off-balance sheet notional amounts into equivalent on-balance sheet exposures.

Credit commitments and unutilised approved credit facilities represent commitments that have not been drawndown or utilised. The notional amount provides the calculation base to which a CCF is applied for calculating the EAD. The CCF ranges between 0 per cent and 100 per cent depending on the approach, product type and whether the unutilised amounts are unconditionally cancellable or irrevocable.

The table below summarises the notional principal amounts, RWAs and capital requirements for each credit-related contingent category:-

	Notional principal amount	RWA	Capital requirement
	US$ millions	US$ millions	US$ millions
Direct credit substitutes	672.3	654.3	81.8
Transaction-related contingent items	2,020.7	785.2	98.2
Short-term self-liquidating trade-related contingent items	515.2	87.8	11.0
Commitments	1,819.7	830.2	103.8
	5,027.9	**2,357.5**	**294.8**

Commitments include undrawn loan commitments and underwriting commitments under note issuance and revolving facilities, and may be drawndown on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2017, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US$330.7 million.

7.2 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 activity to hedge its own exposure to market risk. Derivative and foreign exchange instruments 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 credit and market 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.

Risk management and capital adequacy report (continued)

31st December 2017

7. Off-balance sheet exposure and securitisations (continued)

7.2 Derivative and foreign exchange instruments (continued)

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 or cash flow hedges.

The aggregate notional amounts for derivative and foreign exchange instruments at 31st December 2017 were as follows:-

	Trading	Hedging	Total
	US$ millions	**US$ millions**	**US$ millions**
Foreign exchange contracts:-			
Unmatured spot, forward and futures contracts	6,727.9	-	6,727.9
Options purchased	770.8	-	770.8
Options written	770.8	-	770.8
	8,269.5	-	8,269.5
Interest rate contracts:-			
Interest rate swaps	4,504.1	12,629.1	17,133.2
Cross currency swaps	1,451.8	-	1,451.8
Options, caps and floors purchased	1,165.2	-	1,165.2
Options, caps and floors written	1,165.2	-	1,165.2
	8,286.3	12,629.1	20,915.4
Commodity contracts:-			
Options and swaps purchased	86.6	-	86.6
Options and swaps written	86.6	-	86.6
	173.2	-	173.2
	16,729.0	**12,629.1**	**29,358.1**

7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the interest rate, foreign exchange, commodity, equity or credit markets defaults prior to the maturity of the contract. The counterparty credit risk for derivative and foreign exchange instruments is subject to credit limits on the same basis as other credit exposures. Counterparty credit risk arises in both the trading book and the banking book.

a) Counterparty credit risk calculation

For regulatory capital adequacy purposes, GIB uses the current exposure method to calculate the exposure for counterparty credit risk for derivative and foreign exchange instruments in accordance with the credit risk framework in the CBB's Basel 3 capital adequacy framework. A capital charge to cover the risk of mark-to-market losses on expected counterparty risk (CVA) is applied to over-the-counter derivatives. Credit exposure comprises the sum of current exposure (replacement cost), and potential future exposure. The potential future exposure is an estimate, which reflects possible changes in the market value of the individual contract during the remaining life of the contract, and is measured as the notional principal amount multiplied by a risk weight. The risk weight depends on the risk categorisation of the contract and the contract's remaining life. Netting of potential future exposures on contracts within the same legally enforceable netting agreement is done as a function of the gross potential future exposure.

Risk management and capital adequacy report (continued)
31st December 2017

7. Off-balance sheet exposure and securitisations (continued)

7.3 Counterparty credit risk (continued)

a) Counterparty credit risk calculation (continued)

The EAD, CVA, RWAs and capital requirements for the counterparty credit risk of derivative and foreign exchange instruments analysed by standard portfolio, is presented in the table below:-

	Exposure at Default (EAD)					
	Current exposure	Future exposure	Total exposure	CVA	RWA	Capital requirement
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Banks	118.8	93.1	211.9	232.3	127.3	15.9
Corporates	84.1	65.8	149.9	102.0	174.8	21.9
Governments	0.4	2.1	2.5	0.6	-	-
	203.3	**161.0**	**364.3**	**334.9**	**302.1**	**37.8**

b) Mitigation of counterparty credit risk exposure

Risk mitigation techniques are widely used to reduce exposure to single counterparties. The most common risk mitigation technique for derivative and foreign exchange-related exposure is the use of master netting agreements, which allow the Group to net positive and negative replacement values of contracts under the agreement in the event of default of the counterparty.

The reduction of counterparty credit risk exposure for derivative and foreign exchange instruments through the use of risk mitigation techniques is demonstrated as follows:-

	Current exposure	Effect of netting agreements	Netted current exposure
	US$ millions	US$ millions	US$ millions
Counterparty credit risk exposure	203.3	(83.7)	119.6

7.4 Securitisations

Securitisations are defined as structures where the cash flow from an underlying pool of exposures is used to secure at least two different stratified risk positions or tranches reflecting different degrees of credit risk. Payments to the investors depend upon the performance of the underlying exposures, as opposed to being derived from an obligation of the entity originating those exposures.

At 31st December 2017, the Group had no exposure to securitisation tranches.

The Group provides collateral management services to five collateralised debt obligations (CDOs) issued between 2002 and 2006. The CDOs are intended to extract relative value from a wide range of asset classes across a broad spectrum of credit ratings. The underlying collateral of the CDOs includes leveraged loans, residential and commercial real estate, consumer finance, lending to small and medium sized enterprises, and other receivables. Each CDO holds up to 35 individual investments.

At 31st December 2017 the underlying investments in the CDOs for which the Group acted as collateral manager amounted to US$0.3 billion. At 31st December 2017, GIB did not hold any exposure to CDOs managed by the Group.

Risk management and capital adequacy report (continued)
31st December 2017

8. Internal capital including other risk types

GIB manages and measures other risk types that are not included under Pillar 1 in the CBB's Basel 3 framework. These are principally covered in the Group's internal economic capital model.

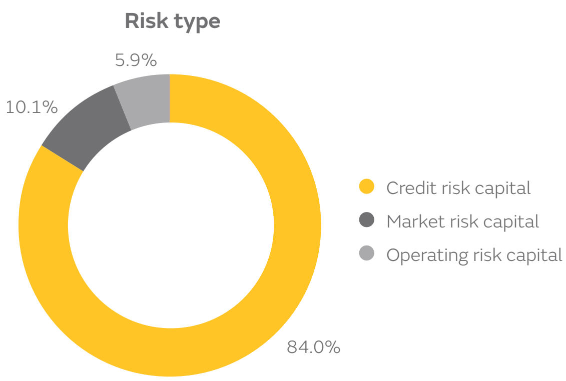
This section describes GIB's economic capital model and discusses the treatment of the other risk types that are not addressed in Pillar 1 of the CBB's Basel 3 framework.

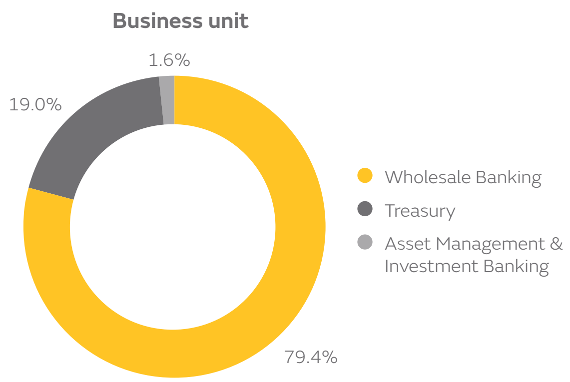
8.1 Economic capital model

For many years, GIB has applied economic capital and risk-adjusted return on capital (RAROC) methodologies which are used for both decision making purposes and performance reporting and evaluation.

GIB calculates economic capital for the following major risk types: credit, market and operating risk. Operating risk includes business risk. Additionally, the economic capital model explicitly incorporates concentration risk, interest rate risk in the banking book and business risk.

The composition of economic capital by risk type and business unit was as follows:-





The primary differences between economic capital and regulatory capital under the CBB's Basel 3 framework are summarised as follows:-

- In the economic capital methodology, the confidence level for all risk types is set at 99.88 per cent, compared to 99.0 per cent in the CBB's Basel 3 framework
- Credit risk is calculated using GIB's estimates of probability of default, loss given default and exposures at default, rather than the regulatory values in the standardised approach
- The economic capital model utilises GIB's embedded internal rating system, as described in more detail later in this section of the report, to rate counterparties rather than using the ratings of credit rating agencies or the application of a 100 per cent risk-weighting for unrated counterparties
- Concentration risk is captured in the economic capital model through the use of an internal credit risk portfolio model and add-on factors where applicable
- The economic capital model applies a capital charge for interest rate risk in the banking book
- The economic capital model applies a business risk capital charge where applicable

Internal rating system

The economic capital model is based on an internal credit rating system. The internal credit rating system is used throughout the organisation and is inherent in all business decisions relating to the extension of credit. A rating is an estimate that exclusively reflects the quantification of the repayment capacity of the customer, i.e. the risk of customer default.

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium-term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits. The internal credit rating system also serves as a key input into the Group's RAROC performance measurement system. Ratings reflect a medium-term time horizon, thereby rating through an economic cycle.

Risk management and capital adequacy report (continued)
31st December 2017

8. Internal capital including other risk types (continued)

8.1 Economic capital model (continued)

The internal ratings map directly to the rating grades used by the international credit rating agencies as illustrated below:-

Internal rating grade	Internal classification	Fitch and Standard & Poor's	Moody's
Investment grade			
Rating grade 1	Standard	AAA	Aaa
Rating grade 2	Standard	AA	Aa
Rating grade 3	Standard	A	A
Rating grade 4	Standard	BBB	Baa
Sub-investment grade			
Rating grade 5	Standard	BB	Ba
Rating grade 6	Standard	B	B
Rating grade 7	Standard	CCC	Caa
Classified			
Rating grade 8	Substandard	CC	Ca
Rating grade 9	Doubtful	C	C
Rating grade 10	Loss	D	-

The rating mapping does not intend to reflect that there is a fixed relationship between GIB's internal rating grades and those of the external agencies as the rating approaches differ.

8.2 Other risk types

a) Liquidity risk

The Group has established approved limits which restrict the volume of liabilities maturing in the short term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 30 day period. The liquidity limits ensure that the net cash outflows over a 30 day period do not exceed the eligible stock of available liquid resources. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

Customer deposits form a significant part of the Group's funding. The Group places considerable importance on maintaining the stability of both its customer and interbank deposits. The stability of deposits depends on maintaining confidence in the Group's financial strength and financial transparency.

The funding base is enhanced through term financing, amounting to US$3,263.6 million at 31st December 2017. Access to available but uncommitted short-term funding from the Group's established GCC and international relationships provides additional comfort. In addition to the stable funding base, the Group maintains a stock of liquid and marketable securities that can be readily sold or repoed.

At 31st December 2017, 67.7 per cent of total assets were contracted to mature within one year. With regard to deposits, retention records demonstrate that there is considerable divergence between their contractual and effective maturities.

US$12,600.2 million or 69.5 per cent of the Group's deposits at 31st December 2017 were from GCC countries. Historical experience has shown that GIB's deposits from counterparties in the GCC region are more stable than deposits derived from the international interbank market. At 31st December 2017, placements and other liquid assets with counterparties in non-GCC countries were greater than the deposits received, demonstrating that the Group is a net lender of funds in the international interbank market.

b) Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. the risk inherent in doing business with large customers or being overexposed in particular industries or geographic regions. GIB's internal economic capital methodology for credit risk addresses concentration risk through the application of a single-name concentration add-on.

Risk management and capital adequacy report (continued)

31st December 2017

8. Internal capital including other risk types (continued)

8.2 Other risk types (continued)

b) Concentration risk (continued)

Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15 per cent of the regulatory capital base. At 31st December 2017, the following single obligor exposure exceeded 15 per cent of the Group's regulatory capital base (i.e. exceeding US$384.5 million).

	On-balance sheet exposure	Off-balance sheet exposure	Total exposure
	US$ millions	US$ millions	US$ millions
Counterparty A	616.5	0.3	616.8
Counterparty B	518.2	0.2	518.4
Counterparty C	427.0	-	427.0

c) Interest rate risk in the banking book

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 of the Group's assets and liabilities, including the trading book, are set out in the table below:-

	Within 3 months	Months 4 to 6	Months 7 to 12	Over 1 year	Non-interest bearing items	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
Cash and other liquid assets	3,715.6	39.5	-	-	13.4	3,768.5
Securities purchased under agreements to resell	755.0	100.0	-	-	-	855.0
Placements	5,097.8	418.8	516.6	-	-	6,033.2
Trading securities	13.0	-	-	-	178.8	191.8
Investment securities:						
- Fixed rate	274.9	50.0	135.0	718.1	-	1,178.0
- Floating rate	2,618.9	30.7	-	-	(4.5)	2,645.1
- Equities	-	-	-	-	170.7	170.7
Loans and advances	8,669.3	1,443.9	82.5	-	(152.6)	10,043.1
Other assets	-	-	-	-	585.9	585.9
Total assets	**21,144.5**	**2,082.9**	**734.1**	**718.1**	**791.7**	**25,471.3**
Deposits	16,592.1	1,122.5	375.3	29.0	-	18,118.9
Securities sold under agreements to repurchase	940.8	189.7	-	-	-	1,130.5
Other liabilities	-	-	-	-	547.4	547.4
Term financing	3,263.6	-	-	-	-	3,263.6
Equity	-	-	-	-	2,410.9	2,410.9
Total liabilities & equity	**20,796.5**	**1,312.2**	**375.3**	**29.0**	**2,958.3**	**25,471.3**
Interest rate sensitivity gap	**348.0**	**770.7**	**358.8**	**689.1**	**(2,166.6)**	**-**
Cumulative interest rate sensitivity gap	**348.0**	**1,118.7**	**1,477.5**	**2,166.6**	**-**	**-**

Risk management and capital adequacy report (continued)
31st December 2017

8. Internal capital including other risk types (continued)

8.2 Other risk types (continued)

c) Interest rate risk in the banking book (continued)

The repricing profile is based on the remaining period to the next interest repricing date. 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 investment security and loan provisions are classified in non-interest bearing items.

The substantial majority of assets and liabilities reprice within one year.

Interest rate asset exposure beyond one year amounted to US$718.1 million or 2.8 per cent of total assets. This exposure principally represented the investment of the net free capital funds in fixed rate government securities. At 31st December 2017, the modified duration of these fixed rate government securities was 3.24. 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 was US$280,700.

Based on the repricing profile at 31st December 2017, 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 (100 basis points) increase in interest rates across all maturities would result in an increase in net income before tax for the following year and the Group's equity of approximately US$14.2 million and US$14.4 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.

d) Foreign exchange risk

The Group does not maintain material foreign currency exposures. 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.

e) Business risk

Business risk represents the earnings volatility inherent in all businesses due to the uncertainty of revenues and costs due to changes in the economic and competitive environment.

For economic capital purposes, business risk is calculated based on the annualised cost base of applicable business areas.

9. Capital adequacy ratios and other issues

9.1 Capital adequacy ratios

The Group's policy is to maintain a strong capital base so as to preserve investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout or the issue of new shares.

The capital adequacy ratios of GIB's principal subsidiary, GIBUK, and the Group were as follows:-

	GIBUK	Group
Total RWAs (US$ millions)	1,205.7	16,410.3
Capital base (US$ millions)	313.6	2,563.5
Tier 1 capital (US$ millions)	313.6	2,410.9
Tier 1 ratio (per cent)	**26.0**	**14.7**
Total ratio (per cent)	**26.0**	**15.6**

GIB aims to maintain a minimum tier 1 ratio in excess of 10.5 per cent and a total capital adequacy ratio in excess of 14.0 per cent.

Risk management and capital adequacy report (continued)

31st December 2017

9. Capital adequacy ratios and other issues (continued)

9.1 Capital adequacy ratios (continued)

Strategies and methods for maintaining a strong capital adequacy ratio

GIB prepares multi-year strategic projections on a rolling annual basis which include an evaluation of short-term capital requirements and a forecast of longer-term capital resources.

The evaluation of the strategic planning projections have historically given rise to capital injections. The capital planning process triggered the raising of additional tier 2 capital through a US$400 million subordinated debt issue in 2005 to enhance the total regulatory capital adequacy ratio, and a US$500 million capital increase in March 2007 to provide additional tier 1 capital to support planned medium-term asset growth. A further US$1.0 billion capital increase took place in December 2007 to enhance capital resources and compensate for the impact of likely provisions relating to exposures impacted by the global credit crisis.

9.2 ICAAP considerations

Pillar 2 in the Basel 3 framework covers two main processes: the ICAAP and the supervisory review and evaluation process. The ICAAP involves an evaluation of the identification, measurement, management and control of material risks in order to assess the adequacy of internal capital resources and to determine an internal capital requirement reflecting the risk appetite of the institution. The purpose of the supervisory review and evaluation process is to ensure that institutions have adequate capital to support the risks to which they are exposed and to encourage institutions to develop and apply enhanced risk management techniques in the monitoring and measurement of risk.

GIB's regulatory capital base exceeded the CBB's minimum requirement of 12.5 per cent throughout the year ended 31st December 2017. Based on the results of capital adequacy stress testing and capital forecasting, GIB considers that the buffers held for regulatory capital adequacy purposes are sufficient and that GIB's internal minimum capital targets of 10.5 per cent for tier 1 capital and 14.0 per cent for total capital are adequate given its current risk profile and capital position. The Group's regulatory capital adequacy ratios set out in section 9.1 of this report significantly exceeded the minimum capital targets and are high by international comparison.

GIB uses its internal capital models, economic capital, and capital adequacy calculations when considering internal capital requirements both with and without the application of market stress scenarios. As a number of Pillar 2 risk types exist within GIB's economic capital framework (i.e. interest rate risk in the banking book, concentration risk and business risk), GIB uses its existing internal capital measurements as the basis for determining additional capital buffers. GIB considers the results of its capital adequacy stress testing, along with economic capital and RWA forecasts, to determine its internal capital requirement and to ensure that the Group is adequately capitalised in stress scenarios reflecting GIB's risk appetite.

Risk management and capital adequacy report (continued)
31st December 2017

10. Glossary of abbreviations

ALCO	Assets and Liabilities Committee
AMA	Advanced Measurement Approach
Basel Committee	Basel Committee for Banking Supervision
CBB	Central Bank of Bahrain
CCF	Credit Conversion Factor
CDO	Collateralised Debt Obligation
CVA	Credit Valuation Adjustment
EAD	Exposure at Default
FCA	Financial Conduct Authority (of the United Kingdom)
FVTOCI	Fair Value through Other Comprehensive Income
GCC	Gulf Cooperation Council
GIB	Gulf International Bank B.S.C.
GIBUK	Gulf International Bank (U.K.) Limited
Group	Gulf International Bank B.S.C. and subsidiaries
Group CEO	Group Chief Executive Officer
Group CFO	Group Chief Financial Officer
Group CCO	Group Chief Credit Officer
Group CRO	Group Chief Risk Officer
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
LGD	Loss Given Default
MENA	Middle East and North Africa
ORMF	Operational Risk Management Framework
OTC	Over-The-Counter
PD	Probability of Default
PRA	Prudential Regulation Authority (of the United Kingdom)
PSE	Public Sector Entity
RAROC	Risk-adjusted Return on Capital
RWA	Risk-weighted Assets
VaR	Value-at-Risk

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