GiB

بنك الخليج الدولي

Annual report 2016

Celebrating 40 years

Contents

GIB

Celebrating 40 years






Celebrating 40 years

In 2016, Gulf International Bank (GIB) celebrated its 40th anniversary, which constitutes a significant milestone in the Bank's long and eventful history.

Over the past four decades, GIB has weathered a series of global economic upheavals, financial crises, market crashes and geo-political tensions, only to emerge stronger and fitter, with the experience and resources to face the challenges of a new global economic paradigm with confidence and determination.

Since commencing operations in 1976, GIB has steadily evolved from a loan-driven merchant bank to a full-fledged financial services institution, highly respected for its pioneering spirit, professionalism and integrity; and its ability to leverage its market knowledge and insight for the benefits of its clients.

This has earned GIB a growing reputation as the 'Gulf's International Bank', providing a vital investment and business conduit between the region and the rest of the world.





Gulf International Bank

Gulf International Bank (GIB) is a full-fledged financial services institution, working in partnership with its clients to deliver innovative bespoke banking solutions. These cover conventional and Shariah-compliant corporate banking, debt and equity capital market-related services, financial advisory, asset management and treasury; together with the MENA region's first Shariah-compliant digital retail bank, *'Meem'* (*meem*م). Supported by cutting-edge technology and high-calibre human capital, the Bank operates in strict accordance to the highest global standards of ethical and professional conduct.

GIB employs over 1,100 professionals across the globe. Its principal subsidiaries are London-based GIBUK Limited (GIBUK) and Riyadh-based GIB Capital in the Kingdom of Saudi Arabia. The Bank has international branches in London and New York; regional branches in Riyadh, Jeddah and Dhahran in Saudi Arabia, and Abu Dhabi in the United Arab Emirates (UAE); together with a representative office in Dubai, UAE.

Commencing operations in the Kingdom of Bahrain in 1976, GIB is licensed by the Central Bank of Bahrain as a conventional wholesale bank. Owned by the governments of the six Gulf Cooperation Council (GCC) countries, GIB's principal shareholder is the Public Investment Fund of the Kingdom of Saudi Arabia, with a majority stake of 97.2 per cent.

Vision

To be the preferred Financial Services Partner, delivering innovative solutions.

Board of Directors

H.E. Jammaz bin Abdullah Al-Suhaimi
Chairman since 2008
Kingdom of Saudi Arabia

H.E. Sulaiman bin Abdullah Al-Hamdan
Resigned from the Board on 2 November 2016
Vice Chairman since 2015
Director since 2009
Kingdom of Saudi Arabia

Prof. Abdullah bin Hassan Alabdulgader
Elected Vice Chairman on 23 December 2016
Director since 2009
Kingdom of Saudi Arabia

Mr. Abdulla bin Mohammed Al Zamil
Director since 2009
Kingdom of Saudi Arabia

Mr. Khaled bin Saleh Al-Mudaifer
Director since 2009
Kingdom of Saudi Arabia

Mr. Omar Hadir Al-Farisi
Director since 2012
United States of America

Dr. Yahya A. Alyahya
Director since 2015
Chairman, Gulf International Bank (UK) Limited
Kingdom of Saudi Arabia

Mr. Abdulaziz A. Al-Helaissi
Elected to the Board 30 November 2016
Group Chief Executive Officer,
Gulf International Bank
Kingdom of Saudi Arabia

Financial highlights

	2016	2015	2014	2013	2012	2011
Earnings (US$ millions)						
Net income after tax	**37.3**	90.4	85.6	121.5	117.9	104.5
Net interest income	**190.0**	188.2	158.0	163.1	149.4	143.8
Fee and commission income	**66.2**	70.2	62.9	62.0	56.7	48.5
Operating expenses	**219.0**	192.1	164.9	151.6	136.1	119.8
Financial position (US$ millions)						
Total assets	**22,905.8**	24,192.4	21,300.2	21,156.9	17,704.8	16,788.9
Loans	**9,745.1**	9,161.4	7,931.5	8,317.2	7,110.3	6,751.8
Investment securities	**4,066.4**	3,884.5	3,944.5	3,725.8	3,560.1	3,151.7
Senior term financing	**2,761.6**	2,420.0	3,372.9	2,332.9	2,432.7	3,690.3
Equity	**2,357.4**	2,431.0	2,350.7	2,264.0	2,130.2	1,962.8
Ratios (per cent)						
Profitability						
Return on average equity	**1.6**	3.8	3.7	5.5	5.8	5.4
Return on average assets	**0.2**	0.4	0.4	0.6	0.7	0.6
Capital						
Risk asset ratio (Basel 2)						
- Total	**16.8**	17.8	19.6	18.9	20.1	23.3
- Tier 1	**15.7**	16.8	18.1	16.9	17.4	19.2
Equity as % of total assets	**10.3**	10.0	11.0	10.7	12.0	11.7
Asset quality						
Securities as % of total assets	**18.2**	16.4	18.9	17.9	20.7	19.3
Loans as % of total assets	**42.5**	37.9	37.2	39.3	40.2	40.2
Liquidity						
Liquid assets ratio	**55.0**	60.0	60.9	58.8	57.9	58.2
Deposits to loans cover (times) [1]	**1.9**	2.1	2.2	2.1	2.0	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	Stable

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 2016. This proved to be one of the most testing periods for the GCC region since the financial crisis of 2008. The year was marked by low oil prices, a regional liquidity shortage, higher costs of funding, economic and market volatility, fiscal reforms and geo-political tensions. In addition, unexpected events such as Brexit and election results in the US and Europe, raised new concerns and a greater degree of uncertainty. Against such challenging headwinds, I am pleased to report that the Bank posted a resilient overall performance.

Financial results

GIB reported total income of US$300.0 million for 2016 compared with US$308.0 million in the previous year; although the total income of the Bank's core Wholesale Banking and Treasury business activities recorded year-on-year increases of 8.5 per cent and 5.0 per cent, respectively. Total operating expenses were US$219.0 million versus US$192.1 million in 2015, with the increase principally attributable to costs associated with growing and building the bank, in particular depreciation and maintenance of newly implemented information technology assets, higher personnel costs, and premises upgrades. Net income after tax was US$37.3 million compared with US$90.4 million in the previous year. The lower level of profitability is in line with financial forecasts and expectations. With effect from 1st January 2016, GIB early adopted the provisioning and hedging guidelines of the IFRS 9 accounting standard. These new accounting guidelines are mandatory with effect from 1st January 2018. On implementation at 1st January 2016, this resulted in increased provisions of US$68.7 million that were adjusted against shareholders' equity. The increase in provisions was attributable to the adoption of a forward looking expected credit loss methodology for the calculation of non-specific provisions.

Return on equity has been modest due to the Bank's business model, and we expect this to continue in the short-term as we focus on building the Bank for the future. However, following the planned breakeven of the new retail bank in the next two to three years, we envisage returns to improve significantly.

GIB continued to maintain a strong balance sheet. Consolidated total assets at the end of 2016 stood at US$22.9 billion compared with US$24.2 billion at the end of the previous year, with the asset profile reflecting a high level of liquidity. Cash and other liquid assets, and short-term placements, totalled US$8.4 billion and represented 36.9 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 2016 totalled US$9.7 billion compared with US$9.2 billion at the previous year end.

H.E. Jammaz bin Abdullah Al-Suhaimi
Chairman
Kingdom of Saudi Arabia

Funding position

GIB's funding derives primarily from wholesale customer deposits, which totalled US$13.45 billion at the end of 2016, accounting for 84 per cent of total deposits, and exceeding loans and advances by almost 1.4 times. GIB raised new senior term financing in 2016 through the issuance of an oversubscribed SAR 2 billion bond that was the first and only financial institution issuance in the domestic Saudi Riyal market since September 2015. The Bank also raised a club loan of US$300 million from international banks during the year. In addition, GIB was the first non-sovereign entity in Central and Eastern Europe, the Middle East, and Africa to issue a bond in 2017. The US$500 million long five-year senior term financing was more than two times oversubscribed.

GIB's robust funding position demonstrates the confidence of the Bank's customers and counterparties based on its strong ownership and financial strength; and confirms the Bank's commitment to diversify its funding sources, and utilise different structures to achieve the most suitable cost of funding. At the end of 2016, GIB's Basel 3 total and tier 1 capital adequacy ratios were a strong 16.8 per cent and 15.7 per cent, respectively.

Ratings confirmation

During the year, the international rating agencies again endorsed their confidence in GIB's financial strength. In December, Fitch Ratings affirmed the Bank's long-term issuer default rating (IDR) at A-, while the viability rating (VR) of bbb- was also affirmed. Fitch highlighted GIB's prudent lending and investment underwriting standards with appropriate risk controls, sound asset quality, and comfortable liquidity buffer supported by highly-liquid assets.

In November, Moody's Investors Service (Moody's) confirmed GIB's prime-2 short-term rating and Baa1 long-term deposit rating. Moody's pointed out GIB's strong capital buffers which are a key credit strength, high liquidity buffers and strong links with creditors, and sound overall strategic re-orientation.

Given the current economic climate and downward pressure on bank ratings in general, 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 a new business strategy.

Strategic progress

We continued to make excellent progress in implementing GIB's strategy to become a pan-GCC universal bank, which is underpinned by five main pillars – wholesale banking, treasury, retail banking, asset management and investment banking. In 2016, we made good progress in strategic focus areas covering cost of funding and diversification of revenue sources; and the leveraging of key enablers such as human capital, service excellence, information technology and operational cost efficiencies. Key strategic developments included the introduction of online global transaction banking (GTB) for corporate customers; a successful first full year of operations for retail banking; restructuring of the asset management business; and re-orientation of the financial institutions group (FIG) as a revenue-generating business.

Corporate milestone

In 2016, GIB celebrated its 40th anniversary, which constitutes a significant milestone in the history of the Bank. During the past four decades, GIB has weathered global economic upheavals, financial crises, market crashes and geo-political tensions, to steadily evolve from a loan-driven merchant bank to a fully-fledged financial services firm. This milestone provided an ideal opportunity to launch a new distinctive brand identity to reinforce GIB's vision, values, culture and reputation, and with which to herald the start of a new chapter in the Bank's strategic transformation.

Chairman's statement (continued)

Institutional capability
Building a solid and sustainable financial institution remains a key strategic objective of the Bank, and in 2016 we continued to strengthen GIB's institutional capability to support the realisation of our strategy and continued business growth. This involved a renewed focus on the closer alignment of people, products, processes and systems across the organisation. We enhanced our human capital and information technology infrastructure, and streamlined back office processes and procedures to achieve operational cost efficiencies. We also strengthened our corporate governance framework to ensure ongoing compliance in a changing regulatory environment; and intensified our focus on risk management to ensure that GIB remains robust, methodical and resilient in the face of increasingly volatile economic and market conditions.

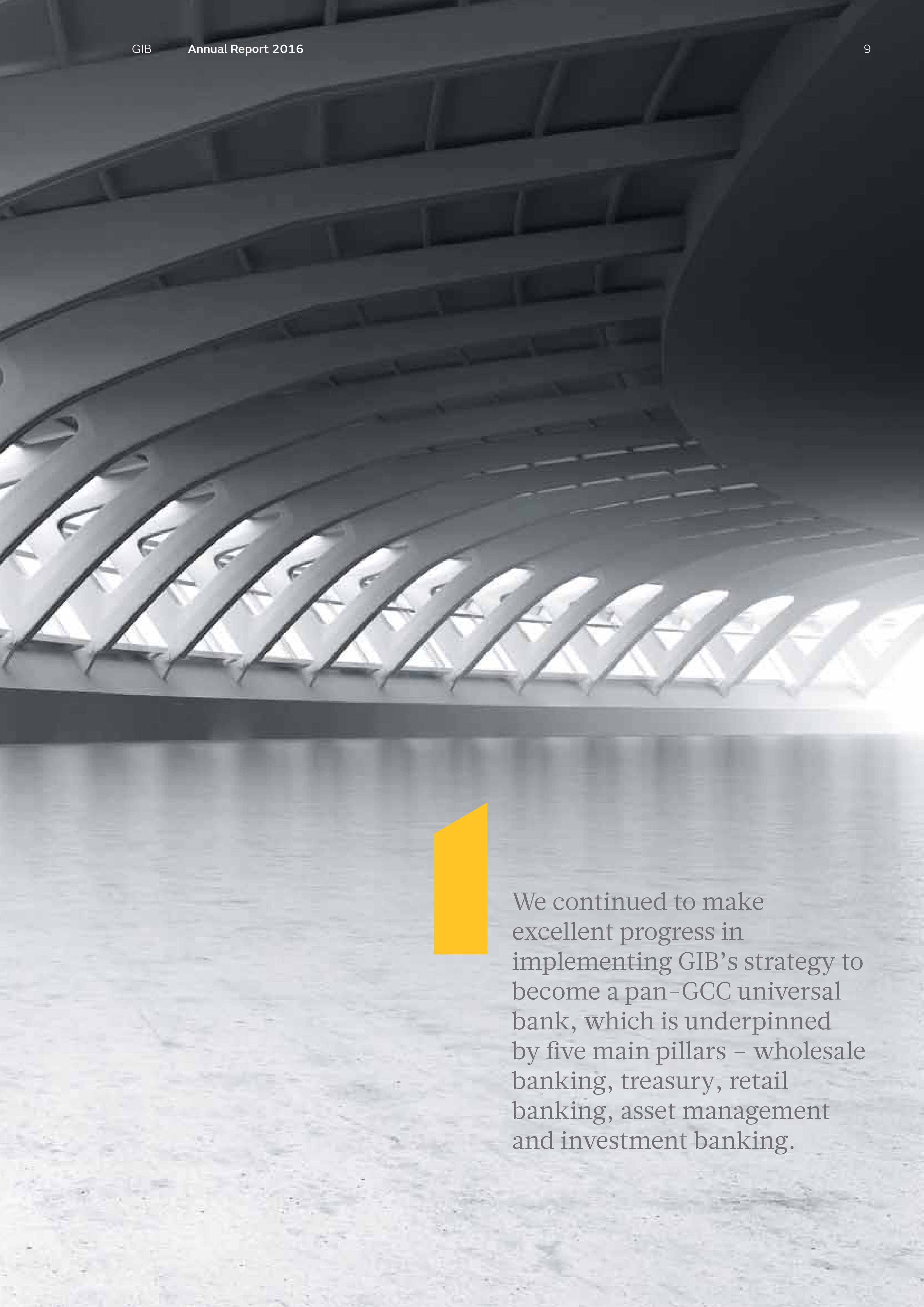
Leadership changes
During the year, there were some leadership changes at both a board and executive management level. Vice Chairman H.E. Mr. Sulaiman bin Abdullah Al-Hamdan resigned from the Board in November, having served as a Director since 2009. The Board of Directors thanks him for his valuable contribution during this time, and wishes him every success in the future. In turn, Professor Abdullah bin Hassan Alabdulgader, who has also served on the Board since 2009, was elected as the new Vice Chairman. Mr Abdulaziz Al-Helaissi, who took over the helm as Group Chief Executive Officer from Dr. Yahya A. Alyahya in February, joined the Board in November.

The Board welcomes Mr. Al-Helaissi, who brings with him decades of banking experience that is uniquely relevant to leading GIB in the next phase of its strategic evolution. He was most recently Deputy Governor (Supervision) of the Saudi Arabian Monetary Agency (SAMA), and previously held senior leadership positions with various banking institutions in Saudi Arabia. The inspired leadership of Dr. Alyahya over the past seven years is deeply valued by the Board. He was instrumental in spearheading the launch of GIB's new business strategy, and laying solid foundations for the Bank's new chapter of strategic transformation and business development. GIB will continue to benefit from the vast experience and expertise of Dr. Alyahya in his capacity as a member of the Board.

Looking ahead
Without doubt, 2017 will be another very challenging period, with the same headwinds that rocked the region in 2016. However, the recent improvement in oil prices and cost of funding; fiscal reforms and economic transformation plans being implemented across the region; and the growing feasibility of a united GCC economic bloc; offer a more positive outlook for the future. GIB will continue to build upon the solid foundations we have put in place in recent years, which will help the Bank in adapting to a new global and regional economic norm. As we enter our fifth decade, 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 renewed energy, confidence and resolve.

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 where 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.

Jammaz bin Abdullah Al-Suhaimi
Chairman of the Board



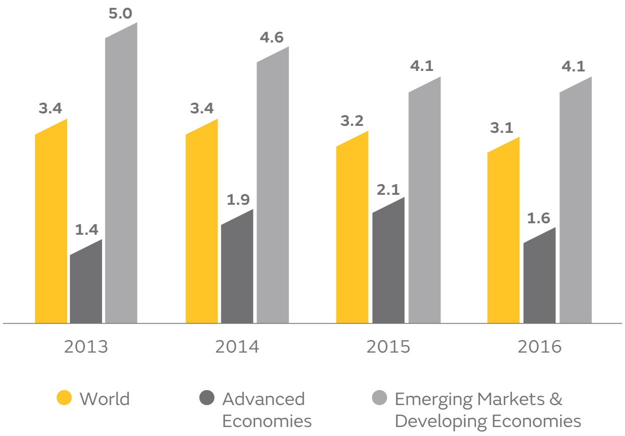
We continued to make excellent progress in implementing GIB's strategy to become a pan-GCC universal bank, which is underpinned by five main pillars – wholesale banking, treasury, retail banking, asset management and investment banking.

Global growth prospects have strengthened, supported by a rebound in the advanced economies and improved expectations in the emerging and developing economies. Across the GCC, an oil price recovery has eased economic and financial stress, while regional countries have embarked on unprecedented structural reform to reduce dependence on oil. However, a number of political, economic and financial risks continue to weigh on overall global sentiment including the pace of monetary tightening and the direction of economic policy in the United States, while the outlook for oil market is clouded by emerging competition from unconventional sources of energy.

Economic review 2016

GLOBAL DEVELOPMENTS

Real GDP Growth (%)



Data Source: International Monetary Fund

Key Trends 2016

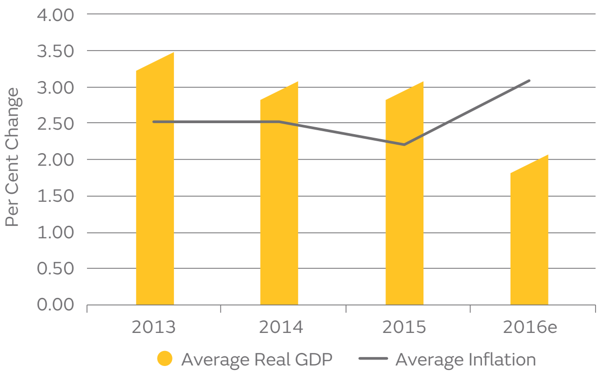
- Global growth trends remained sluggish in 2016, underpinned by stagnant trade, weak investment, commodity price declines, policy uncertainty and heightened political risk.
- Political developments are having a significant impact on global economic developments. The upsurge in anti-establishment and anti-globalisation sentiment delivered a referendum in favour of the United Kingdom exiting the European Union – EU (Brexit) and the election of populist candidate, Donald Trump, to the US presidency.
- Across the advanced economies, activity rebounded in the United States, but remained below potential in other areas, notably in the Eurozone.
- Despite the uncertainty associated with the Brexit vote in June 2016, the economy of the United Kingdom (UK) only experienced a mild slowdown, supported by loose monetary and fiscal policies, coupled with a sharp depreciation of the pound sterling.
- In the emerging markets and developing economies, overall growth levels remained generally stable, albeit with considerable differentiation among countries. Fiscal and monetary policies allowed China's economy to expand at a robust pace while a number of other larger economies experienced a slowdown, notably India, Brazil and Mexico. Oil exporting countries also faced adverse conditions amid low oil prices and challenging supply-demand dynamics.
- Headline inflation rates edged up slightly in advanced economies in 2016 to an estimated 0.7 per cent from 0.3 per cent in the previous year, according to the IMF. Inflation in the emerging markets and developing economies eased marginally from 4.7 per cent to 4.5 per cent, although price pressures ticked up in China following capacity cuts and higher commodity prices.
- Energy markets experienced a tumultuous year, as competition, supply glut and languishing demand depressed prices at the start of the year. However, a shift in fundamentals coupled with an OPEC and non-OPEC agreement to reduce production, have allowed oil prices to recover above the US$50 a barrel mark since the latter part of 2016.
- Global interest rates rose in the second half of the year notably after UK's vote to leave the European Union, hawkish statements by the US Federal Reserve, and policy traction by the European Central Bank. In December 2016, the Federal Reserve raised the short-term federal funds rate to 0.75 per cent, while the monetary policy stance across the other advanced economies remained broadly unchanged. In the emerging markets and developing economies, financial conditions have diverged. Long-term interest rates on local currency bonds rose in Emerging Europe and Latin America, alongside monetary policy tightening in Mexico and Turkey. On the other hand, Brazil, India and Russia cut interest rates.
- Currency and foreign exchange markets were volatile during the year, with pound sterling recording the most significant decline of all major currencies in response to the Brexit vote. Meanwhile, the US dollar index (DXY) rose by 3.6 per cent in 2016 to end the year at 102.2, reflecting a number of factors, including the end of expansive monetary policy by the Federal Reserve and the weakened Euro. Despite this, emerging market currencies also fared relatively well in 2016.

Economic review 2016 (continued)

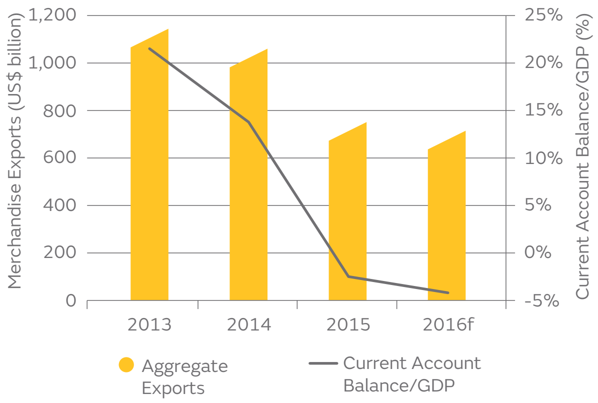
GCC DEVELOPMENTS

The GCC economies continued to adapt to the extended period of low oil prices, embarking on significant policy adjustments including a combination of spending cuts and revenue-raising measures.

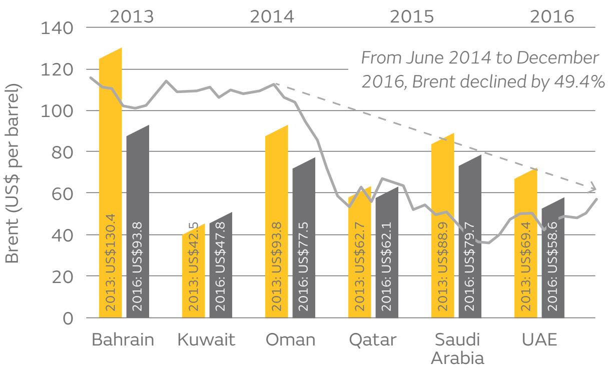
Real GDP & Inflation



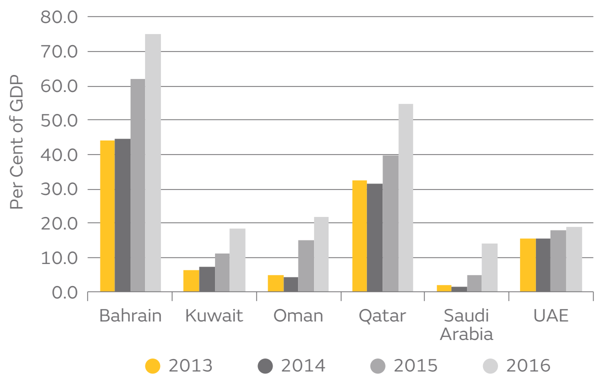
Merchandise Exports & Current Account Balance



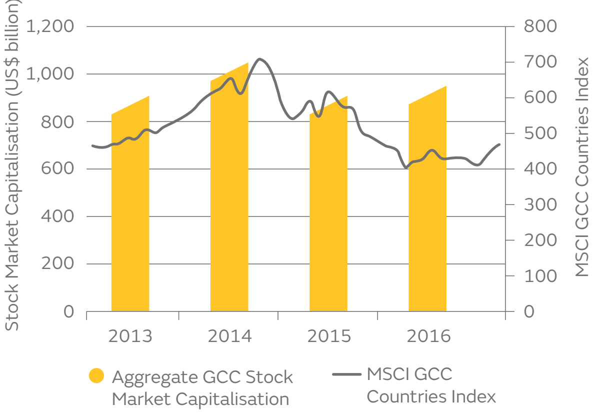
Fiscal Breakeven Oil Prices & Crude Oil Prices



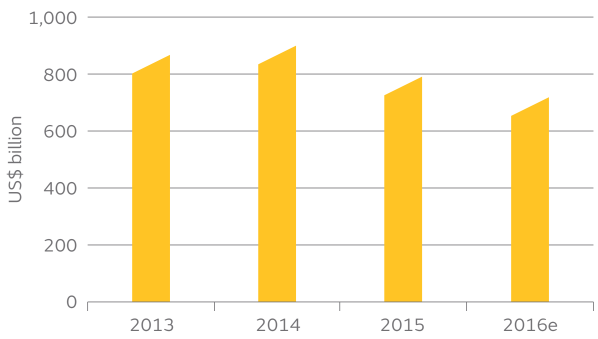
General Government Gross Debt



Stock Market Performance



Foreign Exchange Reserves



Data Source: International Monetary Fund and Bloomberg

GLOBAL & GCC OUTLOOK

Global

- Global growth expectations have improved. The IMF projects world growth to average 3.4 per cent in 2017, supported by a mild rebound in the advanced economies and stabilisation in the emerging markets and developing economies, after undergoing considerable adjustment due to slowing trade and weak commodity prices.
- The global deflationary spiral appears to have turned, and there are increased expectations of broad-based inflation emanating from tightening labour markets; improving energy prices; and potentially higher fiscal spending.
- Despite the improving global conditions, economic prospects are fraught with uncertainties:
  - The rise of populism amid anti-establishment and anti-globalisation sentiment, notably in the advanced economies. This shift has so far delivered the United Kingdom's decision to leave the European Union; the election of Donald Trump as President of the United States; and the strengthening of the populist movement in Europe.
  - The unknown consequences of potential shifts in US economic, trade and foreign policies under the administration of President Donald Trump. These have the potential to create tremendous global financial and economic headwinds, notably in the emerging markets space.
  - Speculation towards the disintegration of the Eurozone will continue, given the improved standing of populist candidates ahead of an important election calendar in 2017, including presidential election in France; parliamentary and presidential elections in Germany; and general election in the Netherlands.
  - The economic, social and political impact of "Brexit" on both the United Kingdom and the EU remains unclear, and continues to be debated.
  - Economic prospects have improved in China, supported by policy stimulus. However, the growth trajectory is vulnerable as leverage continues to build and capital outflows persist.

GCC

- Oil price volatility has eased since the OPEC and non-OPEC countries agreed to cut production in November 2016. GCC growth prospects have improved as a result, with the IMF forecasting regional real GDP to average 2.5 per cent in 2017.
- Driven by "lower-for-longer" oil prices, the emergence of competition from unconventional sources of energy, and continued global uncertainty, GCC countries have embarked on an unprecedented path of structural reform, with Saudi Arabia's Vision 2030 and National Transformation Plan leading the region towards change.
- Despite the sharp deterioration in economic fundamentals, sentiment towards the GCC economies is likely to strengthen as regional governments continue to 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 of revamping the traditional growth model.
- The adjustment process is being supported by low public debt levels and large financial buffers. However, sovereign borrowing is expected to rise sharply as Gulf countries become increasingly reliant on external funding to finance deficits and support the economic reform process.
- Although the economic and financial linkages with oil price developments remain a strain on regional financial systems, GCC banks remain well positioned to cope with volatility in the short term.
- Despite the challenging environment, GCC governments remain committed to the respective currency dollar pegs. In the past, the pegs have endured far more difficult environments.
- Capital market activity has increased to meet funding requirements amid the decline in oil prices. GCC debt issuance has surged, and has largely taken the form of conventional bonds. The trend is likely to continue, while Sukuk issuances also likely to grow.

Management review

This Management Review highlights the key developments that have taken place across the Group over the past year.

2016 saw the introduction of new products and services, and a greater focus and success in cross-selling these and our existing products to a growing client base; new investments in technology to help drive the business; greater emphasis on cost efficiencies and operational controls; and a cultural regeneration that focuses on improved collaboration, perceptiveness, agility and integrity; with equal emphasis on stricter adherence to the highest standards of ethical conduct.

A notable development during the year was the launch of GIB's new corporate identity. Through 40 years of continuous growth and achievements, GIB has always embraced progress and innovation. This is now illustrated in our refreshed brand identity, designed to complement our strategic ambitions in the GCC and beyond. We also celebrated the significant milestone of the Bank's 40th anniversary with a programme of both internal and external events, as well as an increased focus on our corporate social responsibility initiatives.

WHOLESALE BANKING

During 2016, GIB's wholesale banking business continued to make progress in implementing its relationship-based strategy. A key development was the introduction of online global transaction banking (GTB), with initial solutions including cash management and structured trade finance services. This new service is supported by a digital portal, dedicated sales team, and specialist product support teams.

Another important development saw the re-focusing of the Financial Institutions Group from its historical role as a support function to a revenue-generating business line. The Group will consolidate and deepen existing relationships with financial institutions including government entities, banks and other intermediaries, and investors by different business areas of GIB; and establishing new relationships with local, regional and international financial institutions.

GIB also consolidated its growing regional footprint through its corporate banking branches to service clients in the Eastern, Central and Western provinces of Saudi Arabia; and the successful first full year of operations of the Abu Dhabi wholesale banking branch and the Dubai representative office. These offices contributed to the increase of 15 per cent in the Bank's client base in 2016.

During the year, in addition to syndicated transactions, Wholesale Banking successfully concluded several bilateral transactions in Saudi Arabia and other GCC states. Noteworthy conventional and Shariah-compliant financing deals included:

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

Kingdom of Saudi Arabia

- Mandated Lead Arranger, Financier and Hedging Counterparty for a US$664 million 12-year structured Ijara facility to part finance Saudi Arabia Airlines' long term operating lease of eight Airbus A330 aircraft through International Airfinance Corporation (IAFC).
- Arranger for a US$4.7 billion, 7-year term facility to refinance outstanding indebtedness of Yanbu Aramco Sinopec Refinery (YASREF), Saudi Arabia.
- Sole Financier of US$80 million loan to Emirates National Oil Company (ENOC) to facilitate its entry into the Saudi Arabian retail petrol station market.

Other GCC countries

- Global Coordinator, Mandated Lead Arranger and Financier for a US$1.5 billion term facility to part-finance the construction of Pot Line 6 expansion of Aluminium Bahrain (Alba), which is the single largest corporate loan deal in the history of Bahrain.
- Mandated Lead Arranger, Lender, Facility Agent and Security Agent for a US$121.5 million 5-year structured secured vessel financing facility to refinance two very large crude carriers (VLCCs) for Oman Shipping.
- Mandated Lead Arranger, and Security and Facility Agent for US$570 million maiden borrowing by Bahrain's National Oil and Gas Holding Company (NOGA).
- Financial Advisor and Facility Agent for Bahrain National Gas Expansion Company (BNGEC) in its maiden borrowing of US$515 million from a group of regional banks.

The New York branch secured a major US institutional investment in the Bank's flagship Emerging Markets Opportunities Fund (EMOF); and posted record trade finance volumes despite intense competition and challenging economic headwinds. GIB's Shariah-compliant banking (SCB) business continued to provide support to various business units of the Bank by structuring and concluding a number of syndicated and bilateral Shariah-compliant transactions, including regional Sukuk issuances. SCB also established an online commodity trading platform during the year; and enhanced the Bank's Shariah-compliant banking product suite to meet growing client demand.

ASSET MANAGEMENT

A major strategic development in 2016 was the decision to increase GIB's Asset Management capability through its Saudi-based investment banking arm, GIB Capital. Having on-boarded a number of high-calibre professionals, GIB Capital aims to grow the capabilities of its asset management business on the ground in Saudi Arabia and the GCC region by developing a product portfolio that meets the needs of regional clients. This is further enhanced by leveraging the asset management capability of GIBUK, which remains a key pillar of the Group's asset management business, offering a strategic advantage from a global visibility perspective. Products will be rolled out on a gradual basis, with initial focus being on discretionary portfolio management services for equity, followed by fixed income. While building on the success of its flagship Emerging Markets Opportunities Fund (EMOF), GIBUK will also continue to develop new products, including an innovative trade finance fund.

GIB CAPITAL

GIB Capital had another strong year against the backdrop of a slowdown in capital market activities. Equity Capital Markets (ECM) continued to close transactions and win new mandates during 2016, despite the headwinds being faced by the investment banking industry. Debt Capital Markets (DCM) had a record year, closing five capital markets transactions, and being ranked number one in the Saudi domestic market and seventh in the GCC for Sukuk issuances. Debt Advisory (DA) successfully completed a number of debt arranging mandates as well as debt re-profiling mandates.

ECM grew its client base in 2016, encompassing mergers and acquisitions (M&A), public-private partnership (PPP) and valuation advisories. New clients include the General Authority for Civil Aviation (GACA) for assistance related to the privatisation of a number of airports in the Kingdom; and a large equipment rental company for the sale of a majority shareholding. Early in 2016, ECM completed the private placement of a minority equity stake in Al Mana General Hospitals, which was taken up by Sanabil Investments; as well as the sale of a minority equity stake in Bin Dawood Supermarkets to Investcorp.

Management review (continued)

During its most successful year to date, DCM closed transactions that included a SAR 1 billion 5-year Sukuk issuance for Rawabi Valliance Offshore Services; a US$1.5 billion 5-year Sukuk issuance for the Islamic Development Bank (due March 2021); a SAR 2 billion 5-year bond for Gulf International Bank; a SAR 2 billion 10-year non-call Sukuk for Bank Al Jazira, where GIB Capital acted as sole bookrunner; and a US$1.5 billion 5-year Sukuk for Islamic Development Bank (due December 2021).

Debt Advisory completed a syndicated US$1.5 billion term facility arranged to part-finance the construction of the pot line 6 expansion by Aluminium Bahrain (Alba); the debt re-profiling of bank loans for Methanol Chemicals Company (Chemanol); and acquisition financing arranged for a major investment bank in Bahrain.

During 2016, GIB Capital established an Asset Management division to further augment its capabilities and market positioning; which is a key step towards its mid-term strategy of becoming a fully-fledged investment bank in the Kingdom. Asset management will help to reduce revenue volatility by introducing annuity-based income streams.

GIBUK LIMITED (GIBUK)

GIBUK posted a very good overall performance in 2016, in both its treasury and asset management business lines. The products offered by both businesses continued to be rated highly by clients. The global passive equity business, which represents the bulk of assets under management, was affected by the increased volatility in global equity markets. As a result, income remained neutral, but tracking errors were exceptionally low. Total funds under management at the end of the year increased to US$12.9 billion from US$12.2 billion at the end of 2015.

GIBUK's flagship fund, the Emerging Markets Opportunities Fund (EMOF), which invests in the debt of emerging market economies, returned 4.38 per cent (net of fees) during 2016. This result was achieved with a very low level of volatility, with EMOF maintaining its best-in-class Sharpe ratio of 1.9 since inception in August 2010, as acknowledged by *Eurohedge*. The annualised net return since the fund's launch is 6.85 per cent. This strong track record in delivering risk-adjusted returns prompted inflows during the year from several institutional investors from Asia, the Middle East and North America; and increased assets under management by over 40 per cent.

In an innovative development, GIBUK seeded an in-house trade finance fund with a trial portfolio of US$25 million. Based on its initial success, in providing significantly higher returns than money market funds and only taking modest levels of risk, approval was received to launch it as an external fund during 2017. One of the first of its kind, the new trade finance fund will comprise both conventional and Shariah-compliant versions.

RETAIL BANKING

GIB's Retail division, under the brand name of Meem – the world's first fully Shariah-compliant digital bank – achieved strong growth performance in its first full year of operations, achieving its annual targets by the third quarter despite challenging market conditions. The primary aim of the retail division in 2016 was to grow quickly and gain critical mass by offering services that are 'Simple, Fast and Reliable', 'Savings Focused', and 'Best Market Rates'.

Throughout the year, Meem positioned itself as the best savings rate bank in Saudi Arabia, offering its services to everyone across all market segments. The target to build up a strong liabilities portfolio was achieved, with a particular focus on Meem's market-leading Murabaha deposit proposition. This proposition is unique in the market by having an online fully-integrated straight-through-processing capability of buying and selling commodities to create Islamic deposits, which is a market first in the Islamic banking arena.

Meem continued to offer a wide range of banking products including its popular multi-currency card (holding 4 currencies on the same card), platinum credit cards, personal loans, and flexible current/savings 'one pack' accounts, as well as Murabaha Deposits. A wide-ranging online marketing campaign was conducted throughout the year to increase brand awareness and drive acquisitions. Active presence in the social media space also enabled Meem to double its audience reach through channels such as Facebook, Twitter, LinkedIn and Instagram.

TREASURY & INVESTMENTS

GIB's core treasury business, operating out of Bahrain, Saudi Arabia, Abu Dhabi and London, continued to perform strongly in 2016. Building on the firm foundations put in place over the past two years, the division invested in people and systems to further enhance the scope and quality of service provided to clients. The teams in Bahrain, Saudi Arabia and Abu Dhabi were expanded; while the introduction of new systems have considerably improved the time required to bring new products to market.

In the face of increasing economic headwinds, GIB adopted a flexible and proactive approach, partnering with clients to better meet their needs with appropriate hedging and yield-enhancement solutions. The Client Solutions Desk continued to upgrade and diversify its range of treasury solutions; while a new analytics capability was introduced to enhance understanding of clients' businesses in order to meet their requirements.

During the year, Treasury increased the number of bespoke conventional and Shariah-compliant treasury solutions through which to enhance cross-sell with the wholesale banking business. In line with its commitment to the highest levels of corporate governance and international best practice, GIB adopted early compliance with the European Market Infrastructure Regulation (EMIR), which lays down rules on over-the-counter (OTC) derivatives, central counterparties and trade repositories.

GIB's funding profile remained healthy in 2016, demonstrating continued confidence from existing clients and counterparties. Treasury was successful in attracting new clients and fresh deposits to support the growth in the Bank's loan portfolio. Proactive management and tactical allocation, combined with an opportunistic and risk-averse approach, enabled GIB to respond successfully to market volatility during the year, and further grow its investment portfolios. These comprise highly-rated bonds and Sukuks issued by governments, supra-nationals, financial institutions and corporates. The composition of the liquidity portfolio was adjusted in light of changing market conditions and regulations without impairment to quality.

INDUSTRY RECOGNITION

The Bank's strong business performance was further recognised during the year with the receipt of additional industry awards, including GIB being named 'Safest Bank in Bahrain' by *Global Finance*. GIB Capital won four awards: 'Best Supranational Sukuk' and 'Best Syndicated Ijara Facility' at the *EMEA Finance* Awards; and 'Best Debt Bank in the Middle East' and 'Best Investment Bank in Bahrain' at the *Global Finance* Awards. GIBUK was named 'Regional Equities Manager of the Year' and 'Bahrain Asset Manager of the Year' at the *Global Investor/ISF* Awards. In addition, GIBUK's flagship Emerging Markets Opportunities Fund (EMOF) was named 'Best Hedge Fund' at the *MENA Fund Manager* Performance Awards, and was also nominated for a *Eurohedge* Award.

RISK MANAGEMENT

The main focus in 2016 continued to be on managing the impact to the Bank's credit risk profile due to the changing economic and market environment resulting from the steep decline in oil prices and resulting liquidity crunch, and reduced government expenditure across the GCC region. In response, GIB established two new management-level committees. The Credit Committee, which meets once a week, reviews and approves new exposures, clients and renewals for wholesale banking activities; and the Investment Committee, which meets monthly, reviews the composition of the Bank's investment portfolios and monitors the liquidity profile. In addition, GIB appointed external consultants to review the Bank's risk framework and policies against international best practice.

In line with regulatory requirements, the Bank's business continuity plan (BCP) and disaster recovery (DR) policies and procedures were tested during the year. Two separate tests, covering connectivity (people and systems), and a full simulation exercise were successfully conducted. The Bank's information security framework was comprehensively reviewed and enhanced through vulnerability assessment and penetration testing (VAPT); and the introduction of new controls, firewalls and security patches to guard against cybercrime.

Detailed information about GIB's risk management framework is covered by the Risk Management & Capital Adequacy Report in this annual report.

COMPLIANCE

During the year, GIB further strengthened its corporate governance framework to ensure that it remains fully compliant with all regulatory requirements in the various jurisdictions in which the bank operates. New initiatives were introduced to instil a culture of compliance across the Group to ensure that the highest standards of ethical and professional conduct are maintained. In this respect, the Code of Conduct was revamped with more stringent requirements. The Code sets forth GIB's core principles and fundamental values, and is applicable to all employees (whether permanent, temporary or on contract) and directors of GIB globally. It provides guidance on rules of conduct, ethics and avoiding conflicts of interest. Compliance with these rules is critical to the integrity of GIB as it ensures maintaining the trust of all stakeholders.

The Bank's Compliance Group, which is an independent division, works closely with management and business units to provide independent review, monitoring and oversight of business operations; with a focus on adherence to legal and regulatory obligations applicable to the offering of the Bank's products and services to its clients across the jurisdictions in which the Bank operates.

The Group enhanced its surveillance to detect and prevent potential money laundering threats by employee, client or counterparty market, through the implementation of a risk-based approach across all asset classes in all businesses. The newly-deployed anti-money laundering (AML) transaction monitoring platform utilises sophisticated Know Your Customer (KYC) and AML algorithms to efficiently and effectively risk score clients using various parameters, and monitor their transactions against a set of different scenarios.

Management review (continued)

In striving for a zero-tolerance compliance culture, a Compliance Risk Self-Assessment application was implemented across the Bank. The application helps in reducing or eliminating compliance risk through the identification of high-risk regulatory issues, and ensures its mitigation by introducing necessary controls. One of the key developments during the year was the introduction of a new online training module, covering anti-money laundering and counter financing of terrorism, sanctions and conduct risk. This training program consists of 14 mandatory compliance-related courses, which all employees of the Bank have to complete across the year.

HUMAN CAPITAL

During 2016, GIB continued to enhance its human capital framework to support the ongoing implementation of the Bank's business strategy. The key focus was on improving collaboration and engagement across the organisation, with everyone working towards a shared vision and strategic direction, and aligned goals. This is supported by a cultural shift that embraces a passion to drive the business forward as partners with clients rather than just a provider of products. New initiatives to support this change included enhancing internal communications, and encouraging staff to share their particular skills, knowledge and experience.

Particular emphasis was placed on performance management, with clearly-defined key performance indicators (KPIs), goals and priorities being set for individuals and departments, and measured by quarterly appraisals. New management-level committees were established to monitor business progress on a regular basis, and speed up the execution of projects. The Bank's organisational structure was reviewed and modified to align businesses and geographies more closely with strategic objectives; and the management team was strengthened by filling vacancies either through succession planning or the recruitment of high-calibre professionals with appropriate international expertise and experience, with a special focus on GCC nationals. In 2016, Human Resources strengthened its governance on hiring by including in its Board-approval policy, a section on employment of relatives which includes approved persons. Part of the governance will be for the CEO to annually disclose to the Board, employed relatives of any approved person that are occupying controlled functions within the Bank.

GIB continued its substantial investment in training and development with a focus on ensuring employees have the appropriate skills for their job; attaining relevant professional qualifications; and developing more effective managers and future leaders. The Young Professional Development Programme, which enrols two batches of high-calibre GCC university students every year, conducted its first graduation ceremony in 2016. The Bank maintained its recruitment drive during the year with a focus on key customer-facing areas and critical support functions. At the end of 2016, the headcount was on par with the previous year at 1,111 staff.

INFORMATION TECHNOLOGY

The effective utilisation of information technology (IT) as a strategic driver and business enabler was illustrated during the year by the implementation of a number of key new systems and upgrades across the Bank. These included the delivery of cash management and trade finance capabilities through a Global Transaction Banking (GTB) portal, over 20 new customised treasury products, and full external rebranding in alignment with GIB's new corporate identity. Service improvement was also a key focus, with a new service management platform for incident, problem and defect management being implemented. A total of 57 IT projects were delivered during the year, while 99 per cent uptime was achieved in production.

The appointment of a new Chief Information Officer during the fourth quarter of 2016 resulted in a strategic refocus on simplifying and improving the integration of the Bank's technology infrastructure that exists as a result of the investment made in IT solutions over the past few years. The key objective is to align technology more closely with GIB's business processes and its clients through a more integrated IT infrastructure, while enhancing and speeding up delivery. This entailed a shift from the traditional practice of IT systems delivery to a technology service delivery and management approach.

The Bank's IT strategy is based on the five main strategic pillars of GIB, supported by technology themes that are aligned to the business strategy: (1) client and business centricity; (2) enable liability growth and diversity; (3) agility and results focus; (4) service delivery/ management and architecture design; and (5) IT DNA change. The foundations were laid for a new technology capability in readiness for delivering against the Bank's strategy, through 2017 and beyond.

CORPORATE COMMUNICATIONS

Corporate Communications successfully led the rebranding of GIB, and the celebration of the Bank's 40th anniversary. A programme of community-related events was initiated to celebrate the Bank's 40th anniversary. The new brand identity was rolled out internally and externally through special launch events in Saudi Arabia and Bahrain. These events also included recognition of GIB's 40-year history, and its strategic evolution from a loan-driven merchant bank to a full-fledged financial services institution.

The Bank's internal communications programme was also substantially enhanced during the year with new staff engagement events such as town halls, and more diverse delivery channels. GIB's community engagement and sponsorship activities during 2016 are covered in detail by the Corporate Social Responsibility Review and Events Calendar in this annual report.

FUTURE OUTLOOK

I believe that the future is bright for the GCC. While global market conditions remain volatile and uncertain, the long-term outlook for the region is positive due to the economic transformation and diversification plans being implemented by all GCC governments. This positive outlook is further enhanced by the progress being made towards coordinating and pooling the GCC's combined resources to form the world's sixth-largest economic bloc.

The future is also bright for GIB. The history of the Bank has always been inextricably linked with the development of the GCC since the mid-1970s. Today, our vision and strategies are aligned to the GCC's new future as a united economic bloc. With our unique regional knowledge and market insight, our extensive regional and international presence, and the considerable investments we have made in recent years, GIB is primed to continue supporting the GCC nations in all their shared endeavours. We are also ideally positioned to be the natural partner for local and international companies that have a regional focus, which offers promising new opportunities for GIB across all lines of business. We therefore enter our fifth decade of operations with the same enthusiasm, determination and confidence that has characterised our first 40 years.

During my first year as the Bank's Group CEO, I have witnessed a strong team spirit among staff; and a positive enthusiasm to continue delivering both strong bottom and top line growth for our shareholders, by focusing on delivering products and services for our broad customer community that are both innovative and delivered with service excellence. This approach will be instrumental in helping the Bank navigate successfully through increasingly turbulent times, and achieve its ambitious growth targets.

Abdulaziz Al-Helaissi
Board Member & Group Chief Executive Officer

Corporate social responsibility review

GIB has an enduring commitment to enhance the social well-being and quality of life of the communities in which it operates. The Bank fulfills its responsibilities as a concerned corporate citizen through implementation of WAGIB, its corporate social responsibility (CSR) programme. WAGIB, which means duty, emphasises themes with long-term positive results in the fields of youth and career development, women's empowerment, health awareness and economic development. This Review highlights some of the diverse CSR initiatives undertaken by GIB during 2016.

واجب
WAGIB

SUPPORTING CHARITABLE ENDEAVOURS

Bahrain Down Syndrome Society
In September 2016, GIB inaugurated the 'Ayadi Al Amal' (Hands of Hope) art exhibition and auction in collaboration with the Bahrain Down Syndrome Society at the Bank's Bahrain headquarters. The exclusive exhibition showcased paintings created by children during a GIB staff volunteering day at the Society's Care Centre. All exhibited paintings went on sale by means of a silent auction to raise funds for the Society. During the year, GIB also donated a bus to the Society, which is used for transporting children between their homes and the Care Centre.

Down Syndrome Charitable Association, Saudi Arabia
In October 2016, GIB employees based in Saudi Arabia spent a day at the Association's centre in Riyadh, engaging with the children in games, painting and other activities. This volunteering initiative followed the Bank's donation of SAR 300,000 to the Association earlier in the year, as part of a year-long programme celebrating GIB's 40th anniversary.

Innovative Fundraising by GIB's Global Treasury Team

In March 2016, GIB started its year-long 40th anniversary celebrations with an innovative charitable donation that consisted of 40 per cent of its combined treasury net income from the 40th day of the 40th anniversary year, from treasury activities in Bahrain, Saudi Arabia, UAE, London and New York. The total donation of US$100,000, was divided among four healthcare and education-related charities in Bahrain and Saudi Arabia.

36th Bahrain Marathon Relay

The Bank is a longstanding supporter of the Bahrain Marathon Relay, which is one of the Kingdom's most popular and enduring annual charitable fund-raising events, organised by the Bahrain Round Table in association with the Bahrain Athletics Association. In October 2016, GIB's staff team once again won first place in the financial institutions category, and fourth place overall from among 200 participating teams.

GIB Riyadh Marathon

GIB was title sponsor of this annual event in February 2016, which is Saudi Arabia's premier long-distance running competition. This challenging event comprises an individual race covering the full 42.2 kilometres, and a relay version for teams with up to 4 participants. The Bank's sponsorship included the provision of themed tee-shirts, and an archway and podium marking the starting and finishing line.

Corporate social responsibility review (continued)

RAISING HEALTH AWARENESS

GIBUK Staff Support Cancer Research

In May 2016, staff at the Bank's London-based subsidiary (GIBUK) commenced a 12-week weight loss programme to raise money for cancer research. Funds were raised by the 'Fat Fighters' team through donations and sponsorship by colleagues. This was multiplied 40 times by the Bank in recognition of GIB's 40th anniversary, and donated to Cancer Research UK.

GIB Supports Breast Cancer Awareness

In support of the International Breast Cancer Awareness Month in October 2016, GIB staff in Bahrain organised a number of educational and fundraising activities to raise money for Think Pink Bahrain, and increase awareness of the importance of early detection of breast cancer. Employees raised over US$2,100 which was added to GIB's US$20,000 donation to Think Pink Bahrain earlier in the year, as part of the Bank's 40th anniversary celebrations. GIB's headquarters building in Manama was floodlit in pink during the month, and visitors were greeted with Think Pink-themed adornments in the lobby; while employees' offices in Bahrain and Saudi Arabia were decorated in pink.

GIB Celebrates Bahrain Women's day

On the occasion of the Bahraini Women's day, the Corporate Communications team distributed yellow tulips to all women employees in the Bahrain office.

Blood Donation Campaigns in Bahrain and Saudi Arabia

During September 2016, GIB organised blood donation campaigns for its staff in Bahrain and Saudi Arabia to contribute to the communal blood supply in both kingdoms. A total of 60 members of staff from GIB's offices in Manama and Dhahran took part in the campaign.

GIB Gets Healthy

In a health motivated drive, GIB organised a health day for its employees at the bank's lobby in Bahrain. A general check-up including blood pressure and sugar checks, height, weight and BMI, as well as dental and ophthalmology screenings was organised, in which more than 175 staff members took part. The employees were also able to benefit from nutrition advice and healthy food tasting, alongside fitness and exercise advice, and trial sessions to help the bank's employees plan their fitness programmes.

CARING FOR THE ENVIRONMENT

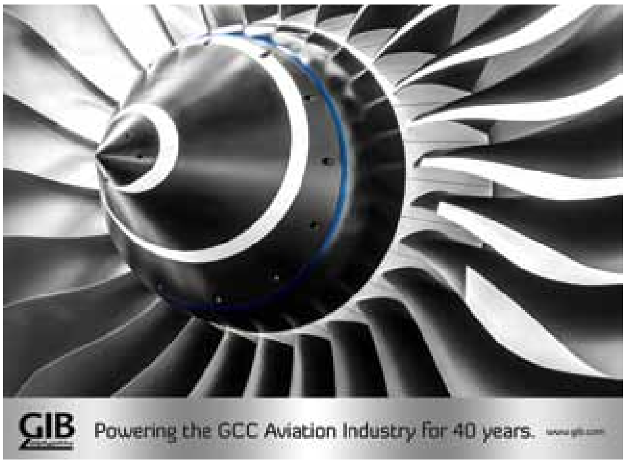
GIB Tree-Planting Initiative Marks World Earth Day
In April 2016, GIB organised a special tree-planting initiative to commemorate World Earth Day. Bank employees and members of the general public gathered on the new Sitra Corniche in support of the initiative. The Capital Governorate provided trees and helped volunteers with the planting; while GIB registered Bahrain on the global campaign site – www.earthday.org – to mark the Kingdom's participation in the global campaign.

GIB 'Beauty and the Beach' Clean-Up Day
In November 2016, scores of environmental enthusiasts, families and children from various schools across Bahrain, joined GIB employees at a 'Beauty and the Beach' clean-up day at Nurana Island Beach, situated near Karranah in the Capital Governorate. This ecological activity was organised in partnership with the Capital Municipality Council, Gulf City Cleaning Company, and the Bahrain Beachcombers. Local graffiti artists painted 24 litter bins for the event, which will remain as a permanent fixture to help make a positive long-term impact on the cleanliness of the beach.

Events calendar

During 2016, GIB hosted, sponsored and participated in a number of keynote industry events in the USA, Saudi Arabia and Bahrain through which to support the development of the regional banking industry and overall economy; while enhancing the image and raising awareness of GIB as the 'GCC's International Bank'.

JANUARY



4th Bahrain International Air Show
GIB sponsored the Saudi Pavilion at the 4th Bahrain International Air Show that took place from 21 to 23 January at the Sakhir Airbase. The Air Show was organised by the Ministry of Transportation and Telecommunications, and the Royal Bahraini Air Force, in cooperation with Farnborough International. It showcased innovative aviation services, technology and products from across the globe, highlighting the evolution of the aviation industry, in both the civilian and defence sectors.

APRIL

Middle East Investment Conference, Bahrain
GIB was platinum sponsor of the 2016 Middle East Investment Conference, held on 13 April in Bahrain, and organised under the patronage of the Central Bank of Bahrain. The conference brought together more than 300 senior investment professionals, offering a unique opportunity for delegates to gain firsthand insights from leading international thought leaders, policymakers, industry experts and key market participants regarding the major investment challenges and opportunities facing the region.

MAY

Euromoney Saudi Arabia Conference (above)
GIB was lead sponsor of the Euromoney Saudi Arabia Conference that took place on 3-4 May in Riyadh. Themed 'Delivering Reform: Maintaining Growth', the conference brought together speakers from the Kingdom's policymakers and financial executives as well as from the international investment community, who shared their thoughts and perspectives on the Kingdom and the Saudi Vision 2030. Over 1,500 senior level financial and business executives attended from the region and around the world, with the aim of understanding the financial opportunities offered by the Saudi market in this time of reform. GIB's Group Chief Executive Officer, Mr. Abdulaziz Al-Helaissi, participated in a Saudi Financial Roundtable; whilst Mr. Ali Achkar, GIB Strategy & Change Head, was a member of a panel entitled 'Building a Digital Financial and Business Ecosystem in the KSA'.

8th Compliance and Anti-Money Laundering Seminar, Saudi Arabia
GIB's Group Chief Executive Officer, Mr. Abdulaziz Al-Helaissi, was an invited speaker at the Thomson Reuters' 8th Compliance & Anti Money Laundering Seminar, held on 9-10 May in Riyadh. The seminar was convened under the patronage of H.E. Abdulaziz Al-Furaih, Vice-Governor of the Saudi Arabian Monetary Agency (SAMA), in partnership with the Kingdom's Institute of Finance. Mr. Al-Helaissi spoke about the impacts of de-risking as large international banks cease to do business with many financial institutions. He noted that this has motivated many banks to invest more in compliance technology and developing the appropriate skillset.

Riyadh Chamber of Commerce Forum, Saudi Arabia
GIB Capital sponsored a forum hosted by Riyadh Chamber of Commerce entitled 'The Conversion of Family Businesses to Listed Companies', held on 25 May in Riyadh under the patronage of H.E. Mohammed A. Al Jadaan, Chairman of the Capital Market Authority (CMA). Around two hundred delegates attended the forum to share case studies highlighting the steps taken by family businesses to strengthen their corporate governance structures and management control systems in preparation for conversion to listed companies. Speakers also highlighted the evolving practices related to the listing process which are designed to facilitate and encourage family-owned businesses to go public.

Events calendar (continued)

AUGUST

Global Ministerial Aviation Summit, Saudi Arabia
GIB sponsored and participated in a panel entitled ‘Financial Institutional Arrangements Related to Regional Projects’ at the Global Ministerial Aviation Summit themed ‘Safety & Security’. Held on 29-31 August in Riyadh under the High Patronage of the Custodian of the Two Holy Mosques King Salman Bin Abdulaziz Al Saud, and organised by The General Authority of Civil Aviation, the summit brought together around 500 delegates from across the globe.

OCTOBER

IMF / World Bank Meeting, Washington DC, United States
GIB hosted a high-profile reception on 7 October during the International Monetary Fund (IMF) and World Bank Group meetings in Washington DC. Hosted by GIB’s Group Chief Executive Officer, Mr. Abdulaziz A. Al-Helaissi, the VIP reception was attended by distinguished guests including central bank governors, finance ministers, policymakers and private sector executives.

From left to right: Mr. Abdulla Al Zamil, GIB Board Member; Dr. Ahmed Abdulkarim Alkholifey, Governor of SAMA; Dr. Yahya Alyahya, GIB Board Member and ex-CEO of GIB; Mr. Abdulaziz Al-Helaissi, CEO of GIB; and H.E. Dr. Ibrahim bin Abdulaziz Al-Assaf, Minister of Finance of Saudi Arabia.

Inaugural GIB Golf Cup, Saudi Arabia

NOVEMBER

GIB New Brand Launch & 40th Anniversary Ceremony, Saudi Arabia
The Bank hosted a special ceremony on 24 November in Riyadh to formally launch GIB's new corporate identity and celebrate its 40th anniversary. The ceremony was attended by 300 guests, including government officials, shareholders, GIB Board members, business partners and clients. GIB's Group Chief Executive Officer, Mr. Abdulaziz A. Al-Helaissi, told the assembled guests that: "Our new brand identity reflects the core of the Bank's new strategy and its Board's vision for GIB to be the preferred financial services partner in delivering innovative solutions to its customers. In line with GIB's expansion and diversification, the new brand will serve as the trademark for all GIB subsidiaries, branches and representative offices in the Arabian Gulf and the rest of the world."

Inaugural GIB Golf Cup Tournament, Saudi Arabia
The Bank hosted its first GIB Golf Cup tournament held on 25 November in Riyadh. The tournament was part of a series of initiatives to reveal the new GIB brand and celebrate the Bank's 40th anniversary, but is set to become an annual event. Held at Dirab Country & Golf Club, the tournament was attended by GIB's key clients and partners who played alongside the Bank's management, together with Dirab Golf Club members and members of the national golf teams of Saudi Arabia and Bahrain.

DECEMBER

GIB New Brand Launch & 40th Anniversary Ceremony, Bahrain
The Bank hosted a reception on 7 December at the Four Seasons Hotel in Bahrain to introduce GIB's new corporate identity and celebrate its 40th anniversary. The ceremony was attended by government representatives, industry officials, business partners and clients. In his speech to guests, GIB Board Member & Group Chief Executive Officer, Mr. Abdulaziz A. Al-Helaissi, explained: "Through 40 years of growth and achievements, GIB has always embraced progress and innovation. This is now personified in a refreshed brand, designed to complement our strategic ambitions in a challenging financial environment."

Financial review

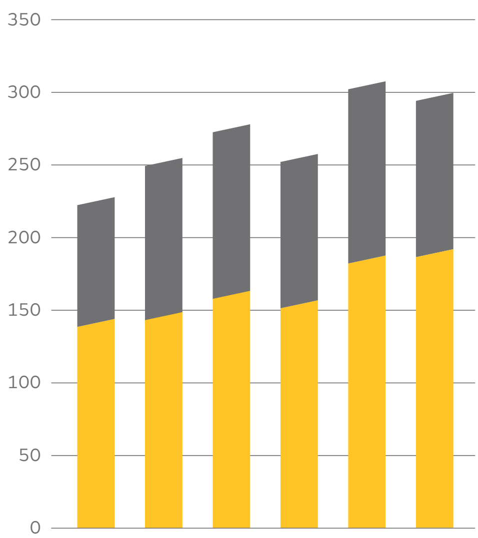
GIB recorded consolidated net income after tax of US$37.3 million for the year ended 31st December 2016, compared to US$90.4 million in the prior year. Total income at US$300.0 million was US$8.0 million or 3 per cent lower than in 2015, with increases in net interest income and trading income being offset by decreases in fee and commission, foreign exchange, and other income. Total expenses increased by US$26.9 million largely associated with GIB's new innovative retail bank, and new core banking and treasury IT systems implemented in the latter part of 2015, resulting in a decrease in net income before provisions and tax of US$34.9 million or 30 per cent.

Net interest income, which at US$190.0 million represented the Bank's largest income source, was US$1.8 million up on the previous year. This reflected increases in all sources of interest income, although in particular increases in both the loan volume 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 large and mid-cap corporates. However, as explained in more detail in the net interest income section of the Financial Review, these increases were largely offset by an increase in the Group's cost of wholesale funding resulting from liquidity constraints in the region. These liquidity constraints prevailed during the first nine months of 2016 although subsided in the fourth quarter of the year.

Fee and commission income at US$66.2 million was US$4.0 million or 6 per cent down on 2015, and comprised almost one quarter of total income. This underlined the success of GIB's strategic focus on relationship-orientated products and services, and enhancement of fee income. Foreign exchange income at US$14.4 million was US$5.4 million lower than in 2015. This 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. The year-on-year decrease reflected an exceptionally high level of income in 2015. Foreign exchange income reverted to a more normalised level in 2016. Trading income at US$11.9 million was US$5.7 million up on, or almost twice, the previous year level. Trading income principally comprised customer-related interest rate derivative income and gains on an investment in a fund managed by the Bank's London-based subsidiary, GIBUK Limited. Other income at US$17.5 million was US$6.1 million lower than in 2015. Other income for 2016 consisted largely of asset recoveries and dividends on equity investments. The year-on-year decrease was due to timing differences in the final dividend declarations in 2015 and 2016.

Total expenses at US$219.0 million for the year were US$26.9 million or 14 per cent up on 2015. The increase was attributable to the ongoing investment in GIB's new retail banking proposition, and new core banking and treasury IT systems which went live in the latter part of 2015. A loan provision charge of US$38.6 million was made in 2016 compared with US$21.3 million in the previous year. In addition, there was a US$1.3 million increase in the non-specific provision for investment securities.

Gross income development (US$ millions)



	2011	2012	2013	2014	2015	**2016**
Non interest income	83.1	105.6	115.2	99.6	119.8	**110.0**
Net interest income	143.8	149.4	163.1	158.0	188.2	**190.0**
Gross income	226.9	255.0	278.3	257.6	308.0	**300.0**

NET INTEREST INCOME

Net interest income at US$190.0 million was US$1.8 million higher than in the prior year.

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

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

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

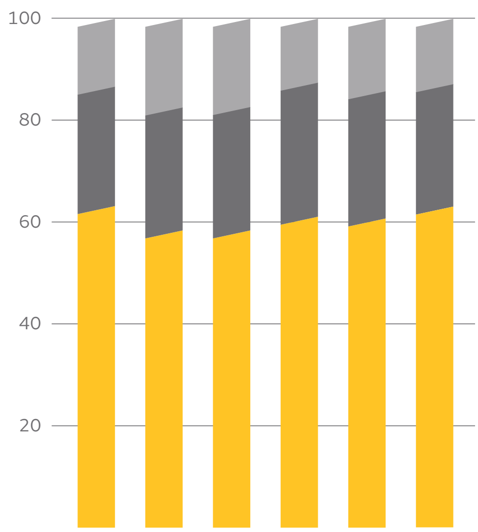
Higher interest earnings were derived from all sources of interest income, i.e. the wholesale loan portfolio, the investment securities portfolio, the money book, and the investment of the net free capital. In addition, there was a lower cost of term finance in 2016. However, these underlying positive trends in interest earnings were largely offset by an increase in the wholesale deposit premium expense resulting from liquidity constraints prevailing in the region during the first nine months of the year. These constraints 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 67 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$29.7 million or 17 per cent higher than in the prior year due to a higher average performing loan volume and an increase in average performing loan margins. The average performing loan volume during 2016 was 11 per cent higher than in 2015 and average performing loan margins were 11 b.p. higher than in 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 to large and mid-cap corporates.

Margin income on the investment securities portfolio accounted for 7 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 11 per cent higher than in the prior year. The year-on-year increase was attributable to a 6 per cent year-on-year increase in the average investment security volume. This more than compensated for a 2 b.p. year-on-year decrease in the average spread on the portfolio resulting from the reinvestment of maturing securities at lower prevailing spreads. 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.

Financial review (continued)

Gross income composition (%)



	2011	2012	2013	2014	2015	**2016**
Foreign exchange, trading & other income	15.2	19.2	19.1	14.3	16.1	**14.6**
Fee & commission income	21.4	22.2	22.3	24.4	22.8	**22.1**
Net interest income	63.4	58.6	58.6	61.3	61.1	**63.3**
	100.0	100.0	100.0	100.0	100.0	**100.0**

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 2016 accounted for 14 per cent of net interest income before the cost of term finance and wholesale deposit premium expense, and were 20 per cent up on the prior year.

Earnings on the investment of the Group's net free capital, which accounted for 9 per cent of net interest income before the cost of term finance and wholesale deposit premium expense, were 9 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. At the end of 2016, 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. Earnings on the net free capital in 2016 and 2015 were, however, negatively impacted by the historically low short-term US interest rates prevailing throughout both years. A rise in US interest rates would have a direct beneficial impact on the Group's interest earnings.

The cost of term finance decreased in 2016 as a result of the maturity of a SAR 3.5 billion (US$933.3 million) term finance facility in April 2015. A new SAR 2.0 billion (US$533.3 million) bond was issued in early 2016 but at a lower cost compared to the bond that matured in 2015. 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 2016, the volume of illiquid assets or assets maturing beyond one year that were funded by non-sticky or short-term deposits represented only 14 per cent of non-sticky customer deposits. The remaining 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$32.3 million or 15 per cent reduction in the Group's net interest income in 2016.

The cost of wholesale deposit premiums increased in 2016 as a result of liquidity constraints in the region. The wholesale deposit premium expense in 2016 increased by US$33.8 million compared to the expense in 2015. The liquidity constraints prevailed during the first nine months of the year although lessened in the fourth quarter 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 in early 2017. Due to the short-term maturity profile of the Group's loan portfolio, an element of the increased cost of wholesale deposits was recovered through the repricing of loans at higher margins.

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$66.2 million was US$4.0 million or 6 per cent lower than in the prior year. An analysis of fee and commission income with prior year comparatives is set out in note 22 to the consolidated financial statements. Investment banking and management fees at US$33.0 million were the largest source of fee-based income, comprising 50 per cent of fee and commission income for the year, while commissions on letters of credit and guarantee at US$29.0 million represented 44 per cent.

Key profitability drivers

Driver	2016	2017 and beyond
Loan volume	Increase in average loan volume	Planned increase in 2017 and beyond to target level of US$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 over the previous year	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	Maturity/prepayment of term facilities	Term finance to be replaced by retail deposits in the medium- to long-term
Fee and commission income	Lower trade finance-related income and lower corporate advisory fees	Focus on cross selling of fee-based products and services
Treasury customer-related income: foreign exchange and interest rate derivatives	Impact of SAMA imposed restrictions on FX structured products	Focus on cross selling of treasury products and development of new products
Operating expenses	Full year depreciation on new IT systems that went live during 2015, and higher retail banking marketing expenses	Stabilisation of expenses
Loan provisions	Higher loans and securities provision charges	Specific provisioning requirements to be reallocated from the non-specific provision buffer

Higher Profitability Lower Profitability Unchanged Profitability

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$5.3 million lower than the prior year level following a US$10.4 million increase in 2015. Income in 2015 was at an exceptionally high level, being more than twice the level recorded in 2014. Fees generated in 2016 were at a more normalised level, albeit lower than in the prior year. Further commentary on the investment banking activity during 2016 is provided in the Management Review section of the Annual Report. Asset and fund management fees in 2016 were much in line with the prior year.

As referred to in note 35 to the consolidated financial statements, assets held in a fiduciary capacity amounted to US$13.0 billion at 31st December 2016 compared to US$12.4 billion at the end of 2015. A small US$0.4 million year-on-year increase in commissions on letters of credit and guarantee reflected an industry sector realignment with a reduction in activity in the construction and contracting sectors. Loan commitment fees at US$3.1 million were US$1.0 million or 48 per cent higher than in the prior year with a higher level of commitment facilities associated with an increase in lending activity.

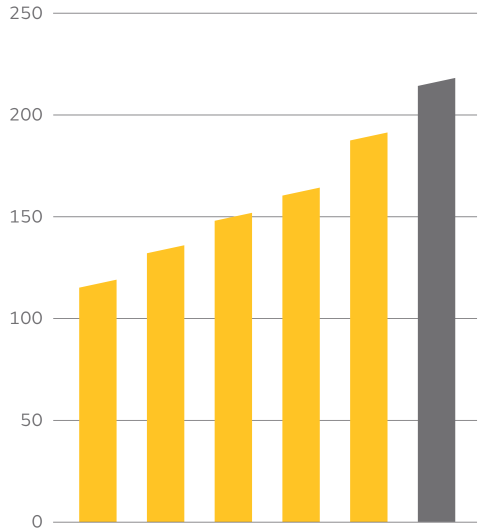
Financial review (continued)

Foreign exchange income at US$14.4 million for the year was US$5.4 million lower than in 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, albeit down on the prior year, reflected the success achieved 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 the products as customers experience the benefits derived from the new products in assisting them to effectively manage and hedge their currency exposures. During 2016 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. The year-on-year decrease in foreign exchange income was due to an exceptionally high level of income recorded by GIBUK in 2015 associated with exceptional customer transaction volume relating to the forward hedging of certain foreign currency exposures.

The Group's various trading activities recorded an US$11.9 million profit for the year compared to a US$6.2 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, including all related funding costs. An analysis of trading income is set out in note 24 to the consolidated financial statements. Trading income in 2016 principally comprised profits recorded on customer-related interest rate derivative income and managed funds. An US$8.8 million profit was generated from customer-related interest rate derivatives, being three times the income recorded in 2015. During 2016, the interest rate derivative product range was expanded and there was 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. The investment in managed funds included an investment in an emerging market government-related debt fund managed by GIBUK. The fund, the Emerging Markets Opportunities Fund, generated a 4.3 per cent return in 2016.

Other income of US$17.5 million was recorded for the year. An analysis of other income is set out in note 25 to the consolidated financial statements. Other income principally comprised US$8.8 million of recoveries of assets previously written off, US$7.3 million of dividends received from equity investments classified as fair value through other comprehensive income (FVTOCI), and a US$1.3 million profit realised on the sale of fixed rate investment debt securities in anticipation of a rise in US interest rates in the medium term. A US$5.3 million year-on-year decrease in dividend income was due to differences in the timing of the final dividend declarations in 2015 and 2016.

Expenses development (US$ millions)



	2011	2012	2013	2014	2015	**2016**
Operating expenses	119.8	136.1	151.6	164.9	192.1	**219.0**

OPERATING EXPENSES

Operating expenses at US$219.0 million were US$26.9 million or 14 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 bank, and new core banking and treasury IT systems which went live in the latter part of 2015.

Staff expenses, which at US$136.9 million accounted for almost two-thirds of total operating expenses, were US$8.5 million or 7 per cent up on the prior year. The year-on-year increase was attributable to an increase in headcount during 2015, principally specialist resources employed on a temporary basis to support the strategy implementation. Certain temporary resources were released in the second half of 2016. As a result, the Group's total headcount of 1,111 at 31st December 2016 was three less than at the end of 2015. The headcount at 31st December 2016 included 202 retail banking front office staff.

Premises expenses at US$18.1 million were US$0.6 million or only 3 per cent up on the prior year. This was due to the full year cost of new office premises for the Abu Dhabi branch and Dubai representative office that opened during 2015.

Other operating expenses at US$64.0 million were US$17.8 million higher than in the prior year. The year-on-year increase was principally due to a full year depreciation expense in 2016 relating to the new IT infrastructure that was implemented during 2015 and marketing expenses relating to the new retail bank.

PROVISIONS

In 2016, there was a US$38.6 million net loan provision charge. The charge comprised the net of a US$39.3 million charge for specific provisions and a US$0.7 million release of non-specific provisions.

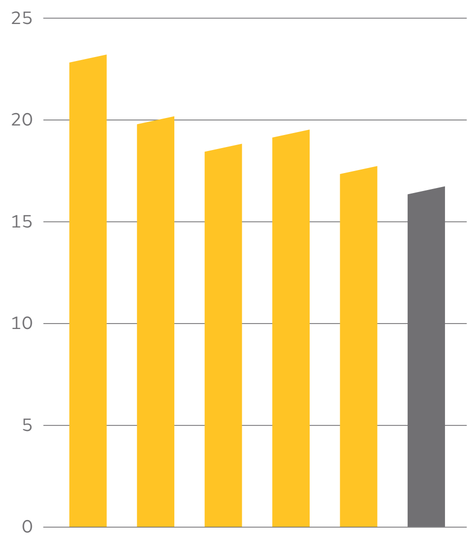
In 2016, the Group early adopted the new expected credit loss impairment methodology for non-specific provisions in accordance with IFRS 9 (2014) Financial Instruments. IFRS 9 (2014) replaces the backward looking incurred loss model in IAS 39 with a forward looking expected credit loss model. Accordingly, 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 impact of the change in the accounting policy was an increase in non-specific provisions of US$68.7 million at 1st January 2016. The increase in provisions was adjusted against retained earnings at that date. There was minimal change in the non-specific loan provisions during 2016, net of transfers to and from specific provisions. The total loan specific and non-specific provision charge equated to 38.0 basis points based on gross loans at 31st December 2016 of US$10,166.1 million. 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$2,357.4 million at 31st December 2016. At the 2016 year end, the ratio of equity and tier 1 capital to total assets were both 10.3 per cent, ratios that are high by international comparison.

A US$73.6 million decrease in total equity during 2016 comprised the net of the US$37.3 million profit for the year, a US$14.9 million net decrease in the fair value of equity investments classified as FVTOCI, and a US$27.3 million decrease in equity arising on the remeasurement of the defined benefit pension fund of the Group's London-based subsidiary, GIBUK. The decrease in the valuation of the defined benefit pension plan was primarily due to the sharp decline in the discount rate used in the mathematical model to discount the plan's future obligations. The decline in the discount rate reflected market reaction to the United Kingdom's vote in July 2016 to exit the European Union. It is expected that the valuation will increase in the short-term as the discount rate rises based on market expectations of a higher interest rate environment.

Risk asset ratio (%)



	2011	2012	2013	2014	2015	**2016**
Risk asset ratio	23.3	20.1	18.9	19.6	17.8	**16.8**

With a total regulatory capital base of US$2,522.9 million and total risk-weighted exposure of US$15,019.8 million, the risk asset ratio calculated in accordance with the Central Bank of Bahrain's Basel 3 guidelines was 16.8 per cent while the tier 1 ratio was a particularly strong 15.7 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.

At 31st December 2016, the regulatory capital base would support an additional US$3.0 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.

Financial review (continued)

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 27.5 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 28 to the consolidated financial statements. The credit risk profile of financial assets, based on internal credit ratings, is set out in note 27.1(b) to the consolidated financial statements. This note demonstrates that 75 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 37 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 2016 were not significantly different to their carrying amounts.

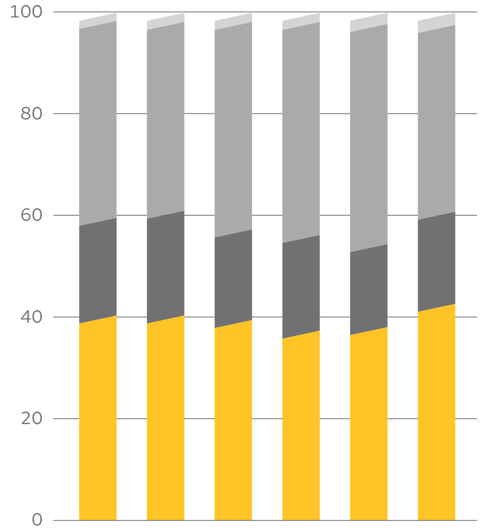
At the 2016 year end, cash and other liquid assets, reverse repos and placements accounted for 37 per cent of total assets, investment securities accounted for 18 per cent, while loans and advances represented 43 per cent.

Investment Securities

Investment securities totalled US$4,066.4 million at 31st December 2016. 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$2,397.2 million, or 63 per cent, of the total investment debt securities at the 2016 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$1,418.1 million at the end of 2016 and comprised investments in OECD and GCC government-

Asset mix by category (%)



	2011	2012	2013	2014	2015	**2016**
Other	1.6	1.8	1.8	1.8	2.2	**2.4**
Placements & other liquid assets	38.9	37.3	41.0	42.1	43.5	**36.9**
Securities	19.3	20.7	17.9	18.9	16.4	**18.2**
Loans & advances	40.2	40.2	39.3	37.2	37.9	**42.5**
	100.0	100.0	100.0	100.0	100.0	**100.0**

related bonds. The Group had no exposure to troubled eurozone government debt, i.e. no exposure to Greek, Irish, Italian, Portuguese or Spanish government debt.

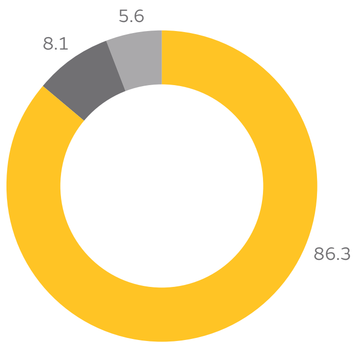
Equity investments at the end of 2016 amounted to US$251.1 million. Equity investments at 31st December 2016 included listed equities amounting to US$167.3 million received in settlement of a secured past due loan. The remaining equity investments largely comprised private equity-related investments.

An analysis of the investment securities portfolio by rating category is set out in note 9.1 to the consolidated financial statements. US$3,292.1 million or 86 per cent of the debt securities at the 2016 year end were rated A- / A3 or above. Based on the rating of the issuer, a further US$310.9 million or 8 per cent of the debt securities represented other investment-grade rated securities.

The fair value of investment debt securities at 31st December 2016 was US$3,692.5 million. The fair value was accordingly only US$16.3 million greater than 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.

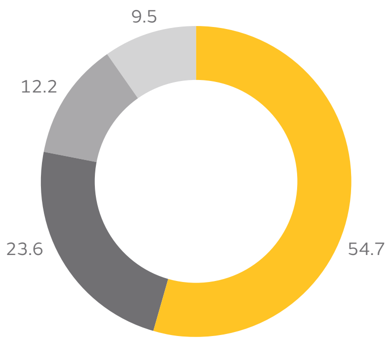
There were no past due or impaired investment securities at 31st December 2016.

Investment debt securities rating profile



	US$ millions	%
AAA to A-/Aaa to A3	3,292.1	86.3
BBB+ to BBB-/Baa1 to Baa3	310.9	8.1
BB+ to BB-/Ba1 to Ba3	212.3	5.6
	3,815.3	**100.0**

Loan maturity profile



	US$ millions	%
Year 1	5,333.5	54.7
Years 2 & 3	2,304.0	23.6
Years 4 & 5	1,185.5	12.2
Over 5 years	922.1	9.5
	9,745.1	**100.0**

Loans and Advances

Loans and advances amounted to US$9,745.1 million at the 2016 year end. This represented a US$583.7 million or 6 per cent increase compared to the 2015 year end. As is evident from note 40 to the consolidated financial statements, the average volume of loans and advances during 2016 was US$9,613.6 million, being US$814.8 million higher than the average volume during 2015.

Based on contractual maturities at the balance sheet date, 55 per cent of the loan portfolio was due to mature within one year while 78 per cent was due to mature within three years. Only 9 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 28. At 31st December 2016, 20 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. 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 to large and mid-cap corporates. There was limited exposure to the construction and real estate sectors at the 2016 year end.

The credit risk profile of loans and advances, based on internal credit ratings, is set out in note 27.1(b) to the consolidated financial statements. US$5,504.8 million or 56 per cent of total loans were rated 4- or above, i.e. the equivalent of investment grade-rated. Only US$161.6 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.

Total loan loss provisions at 31st December 2016 amounted to US$421.0 million. Counterparty specific provisions amounted to US$255.5 million while non-specific provisions were US$165.5 million. Total provisions of US$421.0 million represented 124 per cent of the gross book value of past due loans. There was accordingly a significant buffer of provisions in excess of the volume 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 2016 amounted to US$165.5 million, representing a high 1.7 per cent of non-specifically provisioned loans.

Financial review (continued)

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.

The gross and net book values of past due loans at 31st December 2016 amounted to US$339.3 million and US$94.0 million respectively. The specific provisioning coverage for past due loans was 72 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.

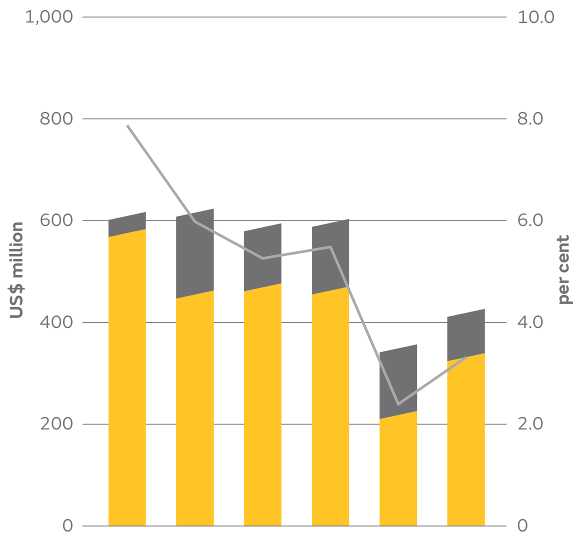
Other Asset Categories

Cash and other liquid assets, amounting to US$3,095.0 million at the 2016 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$4,715.3 million at the 2016 year end and were well diversified by geography as illustrated in note 28 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 21 per cent of total assets at the 2016 year end. A high level of placements was being maintained in the prevailing uncertain and volatile market environment. At the end of 2016, placements were supplemented by US$635.0 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$91.9 million largely comprised investments in managed funds, providing exposure to emerging market government-related debt.

PDO loan development

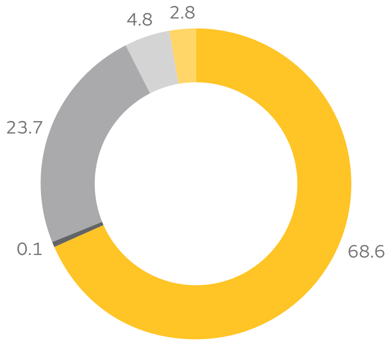


	2011	2012	2013	2014	2015	**2016**
Gross PDO loans (US$ millions)	582.5	462.9	475.9	469.2	225.1	**339.3**
Provisions (US$ millions)	619.2	625.7	591.3	601.1	361.0	**421.0**
Gross PDO loans as % of gross loans	7.9	6.0	5.3	5.5	2.4	**3.3**

Risk Asset and Commitment Exposure

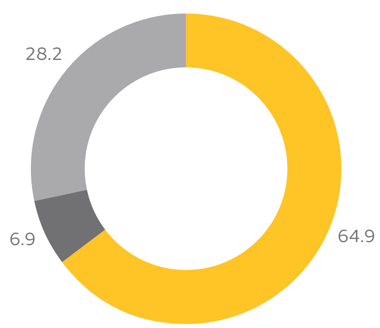
Risk asset and commitment exposure at 31st December 2016 amounted to US$26,645.3 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of other assets) and credit-related contingent items. As referred to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 28 to the consolidated financial statements. As is evident from this note, US$18,278.3 million or 69 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 31 to the consolidated financial statements while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 32.

Risk asset and commitment exposure



	US$ millions	%
GCC	18,278.3	68.6
Other MENA	27.4	0.1
Europe	6,304.6	23.7
North America	1,286.5	4.8
Asia	735.9	2.8
Latin America	12.6	-
	26,645.3	**100.0**

Deposits - geographical profile



	US$ millions	%
GCC countries	10,387.7	64.9
Other MENA	1,102.6	6.9
Other countries	4,511.4	28.2
	16,001.7	**100.0**

FUNDING

Bank and customer deposits at 31st December 2016 totalled US$16,001.7 million. Customer deposits amounted to US$13,447.5 million at the 2016 year end, representing 84 per cent of total deposits. Bank deposits at 31st December 2016 amounted to US$2,554.2 million, representing only 16 per cent of total deposits.

Total deposits are analysed by geography in note 13 to the consolidated financial statements. US$10,387.7 million or 65 per cent of total deposits were derived from counterparties in GCC countries. Deposits derived from non-MENA countries, principally Europe, amounted to US$4,511.4 million or 28 per cent of total deposits. The deposits from counterparties in non-MENA countries largely related to deposit activity by GIBUK. 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$5,678.4 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$1,321.5 million at 31st December 2016. 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. A US$771.9 million decrease in repos compared to the 2015 year end was due to a strategic focus on intra-group repo activity between the Parent Bank and GIBUK in order to increase group funding efficiencies. This is also reflected in a US$1,200.0 million decrease in securities purchased under agreements to resell (reverse repos).

Senior term financing at 31st December 2016 totalled US$2,761.6 million. Term finance and equity represented 116 per cent of loans maturing beyond one year. US$150.0 million of subordinated term financing matured during 2016.

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

Corporate governance report

Sound corporate governance has been essential at Gulf International Bank since its inception, both in achieving organisational integrity and efficiency, and in attaining fairness to all stakeholders.

SOUND GOVERNANCE

When Gulf International Bank B.S.C. ("GIB" or the "Bank") was established 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; and since 2003, GIB has regularly published a statement on corporate governance in its annual reports.

In 2010, when the Central Bank of Bahrain ("CBB") introduced new corporate governance requirements for banks in Bahrain, GIB had already put 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 a detailed Corporate Policy Manual and 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; establishment of a dedicated Corporate Governance Committee; 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 December 2016.

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 Chief Executive Officer (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 57 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 November 2016, Mr Abdulaziz Al Helaissi, the CEO was appointed as a Board member for a 3-year term upon the resignation of H.E. Sulaiman Al Hamdan. Also, in December 2016, the Board assessed its composition and reconstituted its Committees, including the re-election of a new Vice Chairman of the Board Professor Abdullah Alabdulgader, in place of the exiting H.E. Sulaiman Al Hamdan.

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 seven Directors of whom six 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 31 December 2016, two Directors of the Bank were 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 Board did not consider any issues that were outside the ordinary course of business during 2016.

The details of Board membership and Directors' attendance during 2016 are set out in the following table:

DIRECTORS' ATTENDANCE JANUARY - DECEMBER 2016

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	4(6)	4(6)					Non-Executive	Independent
H.E. Sulaiman bin Abdullah Al-Hamdan, Vice Chairman*	5(5)	5(5)		5(5)			Non-Executive	Independent
Professor Abdullah bin Hassan Al-Abdul-Gader	6(6)	6(6)	7(7)			2(2)	Non-Executive	Independent
Mr. Abdulla bin Mohammed Al Zamil	5(6)			5(5)	4(4)	1(2)	Non-Executive	Independent
Mr. Khaled bin Saleh Al-Mudaifer	6(6)		7(7)	5(5)		2(2)	Non-Executive	Independent
Mr. Omar Hadir Al-Farisi	5(6)	5(6)	6(7)		3(4)		Non-Executive	Independent
Dr. Yahya Abdullah Alyahya	5(6)				3(4)		Non-Executive	Non-Independent
Mr. Abdulaziz Al-Helaissi**	1(1)	1(1)					Executive	Non-Independent

* Board membership term ended in November 2016
**Newly appointed in November 2016
Figures in (brackets) indicate the maximum number of meetings during the year.

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 2016)

Board committees	Member name	Member position
Executive Committee	H.E. Jammaz bin Abdullah Al-Suhaimi H.E. Mr. Sulaiman bin Abdullah Al-Hamdan* Professor Abdullah bin Hassan Alabdulgader Mr. Omar Al-Farisi Mr. Abdulaziz Al-Helaissi**	Chairman Member Member Member Member
Audit Committee	Professor Abdullah bin Hassan Alabdulgader Mr. Khaled bin Saleh Al-Mudaifer Mr. Omar Hadir Al-Farisi	Chairman Member Member
Nomination & Remuneration Committee	H.E. Mr. Sulaiman bin Abdullah Al-Hamdan Mr. Abdulla bin Mohammed Al Zamil Mr. Khaled bin Saleh Al-Mudaifer	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	Professor Abdullah bin Hassan Alabdulgader Mr. Abdulla bin Mohammed Al Zamil Mr. Khaled bin Saleh Al-Mudaifer	Chairman Member Member

* Board membership term ended in November 2016
** Newly appointed to the Committee in December 2016

BOARD AND COMMITTEES MEETINGS DURING 2016

Type of meeting	Meeting dates
Board Committee	1. 12 February 2016 2. 27 March 2016 3. 22 April 2016 4. 26 July 2016 5. 14 October 2016 6. 23 December 2016
Executive Committee	1. 12 February 2016 2. 27 March 2016 3. 22 April 2016 4. 26 July 2016 5. 14 October 2016 6. 23 December 2016
Audit Committee	1. 11 February 2016 2. 10 March 2016 3. 21 April 2016 4. 2 June 2016 5. 25 July 2016 6. 13 October 2016 7. 16 December 2016

Type of meeting	Meeting dates
Nomination & Remuneration Committee	1. 11 February 2016 2. 10 March 2016 3. 21 April 2016 4. 26 July 2016 5. 13 October 2016
Risk Policy Committee	1. 11 February 2016 2. 21 April 2016 3. 25 July 2016 4. 13 October 2016
Corporate Governance Committee	1. 11 February 2016 2. 16 December 2016

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 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 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 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 (such as the update on the International Accounting Standards and the remuneration regulations issued by the CBB).

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)
- Human Resources Committee
- Information Security 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.

In 2014, the Bank adopted the Sound Remuneration Practices issued by the CBB, and updated its variable remuneration framework. The Board approved the revised policy 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 the 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$45,000 [2015: US$45,000].

External consultants

Consultants were appointed during 2014 to advise the Bank on amendments to its variable remuneration policy to be in line with the CBB's Sound Remuneration Practices and industry norms. This included assistance in designing an appropriate Share-based Incentive Scheme for the Bank. The NRC also appointed consultants during the year to perform a pay benchmarking exercise to assist them in reviewing the total compensation offered by the Bank.

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 2016, the aggregate remuneration paid to Board members and key Management was US$10.0 million [2015: US$8.6 million] of which US$3.0 million [2015: US$2.3 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 Senior Vice-President ("SVP") and higher shall be subject to deferral of variable remuneration as follows:

Element of variable remuneration	Allocation of variable remuneration: CEO, MDs and the 5 most highly-paid business line employees	Allocation of variable remuneration: SVP 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 be subject to deferral arrangements.

Details of remuneration

Board of Directors

US$ 000's	2016	2015
▪ Sitting Fees	**443**	434
▪ Remuneration Fees	**1,209**	1,148
▪ Others*	**1,272**	995
TOTAL	**2,924**	2,577

* Represents allowances to cover travelling and accommodation while attending Board and related Committee meetings.

Employees

	2016										
		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	Cash	Shares	Others	Total
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**

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.

US$ 000's	2015										
	Number of staff	Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					Total
						Upfront		Deferred			
		Cash	Others	(Cash / shares)	(Cash / shares)	Cash	Shares	Cash	Shares	Others	
Approved persons											
- Business Lines	8	3,162	335	-	-	807	14	184	976	-	5,479
- Control & Support	13	3,411	371	-	-	435	51	30	353	-	4,652
Other Material Risk Takers	8	1,859	262	-	-	207	31	13	189	-	2,560
Other Staff	254	27,165	4,441	-	-	2,958	50	-	199	-	34,812
Overseas Staff	823	55,627	11,399	-	-	7,815	-	-	-	-	74,841
TOTAL	**1,106**	**91,224**	**16,807**	**-**	**-**	**12,222**	**146**	**227**	**1,717**	**-**	**122,344**

Other staff expenses reported in the consolidated statement of income that have not been included in the table above, amounting to US$6.1 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

	2016				
	Cash US$ 000's	Shares		Others US$ 000's	Total US$ 000's
		Number	US$ 000's		
Opening balance	223	1,794,458	1,733	-	1,956
Awarded during the period	227	1,928,744	1,863	-	2,090
Paid out / released during the period	(75)	(749,372)	(724)		(799)
Service, performance and risk adjustments	-	-	-	-	-
Changes in value of unvested awards	-	-	(9)	-	(9)
Closing balance*	**375**	**2,973,830**	**2,863**	**-**	**3,238**

* Closing balance Share value based on NAV as on 31-12-16

Severance pay

The severance payments during the year amounted to US$563,419 [2015: US$219,878] of which the highest paid to a single person amounted to US$222,716 [2015: US$153,645].

Corporate governance report (continued)

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.

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 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 are applicable for adoption in 2016.

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 Policy for the Approval of 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 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 CEO based on a risk-rating matrix. When considering transactions, any exposure to an entity that exceeds the 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, who reports directly to the CEO, also has access to the Board through the Audit Committee, if required.

In ensuring that the tone emanates from the top, the CEO issues a yearly message to all 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 March 2016. 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 2016 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.

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. H.E. Jammaz bin Abdullah Al-Suhaimi (1)
Chairman since 2008
Kingdom of Saudi Arabia

His Excellency Jammaz bin Abdullah Al-Suhaimi is ex-Chairman and Chief Executive of the Saudi Arabian Capital Market Authority (CMA); and ex-Deputy Governor of the Saudi Arabian Monetary Agency (SAMA), which he joined initially as Director General for Banking Control. He also served as Deputy Director General of the Saudi Industrial Development Fund. H.E. Al-Suhaimi is Vice Chairman of Saudi Arabian Investment Company (Sanabil Investments). He has also held board memberships in many leading public and private organisations, including the Saudi Arabian General Investment Authority, the General Petroleum and Minerals Organisation, the National Company for Cooperative Insurance, and the London-based Saudi International Bank (which merged with Gulf International Bank in 1999). H.E. Al-Suhaimi holds a Bachelor's degree in Electrical Engineering from the University of Washington, USA. He has 42 years' professional experience.

2. H.E. Sulaiman bin Abdullah Al-Hamdan
Resigned from the Board on 2 November 2016
Vice Chairman since 2015
Director since 2009
Kingdom of Saudi Arabia

His Excellency Sulaiman bin Abdullah Al-Hamdan is President of the Saudi General Authority of Civil Aviation. Prior to this, he was Board Member and Group Chief Executive Officer of National Air Services (NAS Holding) in Saudi Arabia. He was also a Member of the Saudi Arabian Advisory Commission of the Supreme Economic Council. He previously worked for Saudi British Bank, where his various positions included Deputy Managing Director, and General Manager - Personal Banking; and at the Saudi Fund for Development. H.E. Al-Hamdan is an ex-Member of the Board of Trustees at Al Yamamah University; and an ex-Member of the Advisory Committee to the Industrial Management College at King Fahd University of Petroleum and Minerals, and Prince Sultan University, Saudi Arabia. He previously served as Chairman of Saudi Hollandi Capital; and Board Member of Middle East Specialized Cables Company, and Al Ahlia Cooperative Insurance Company. H.E. Al- Hamdan holds an MBA from the University of New Haven, USA; and a Bachelor's degree in Administrative Science from King Saud University, Saudi Arabia. He has 37 years' professional experience.

3. Prof. Abdullah bin Hassan Alabdulgader (1) (2) (5)
Elected Vice Chairman on 23 December 2016
Director since 2009
Kingdom of Saudi Arabia

Professor Abdullah bin Hassan Alabdulgader is an independent consultant. He serves as Director and Audit Committee Member of several prominent companies, including Saudi Arabian Investment Company (Sanabil), Saudi Arabian Railroads Company (SAR), and Al Faisaliah Group. He is the Chairman of the Board of Saudi Telecom Company (STC). He leads the Regulatory and Policy Oversight Committee at the Saudi Stock Exchange (Tadawul) and the Professional Quality Monitoring Committee at the Saudi Organisation of Certified Public Accountants. 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. Professor 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 35 years' professional experience.

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

Mr. Abdulla Mohammed Al Zamil is Board Member and Chief Executive Officer of Zamil Industrial Investment Company, and 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 (JV PIF and Singapore Ports Authority). Mr. Al Zamil's board memberships include GIBUK Limited, GIB Bahrain, Gulf Insulation Group, Ranco-Zamil Concrete Industries, and Viva Bahrain; together with ZNA INFRA Private Limited-India, Zamil Steel Industries – Egypt and Vietnam, Eastern Province Council (Government Entity), Job Creation Commission (Government Entity), General Authority of Civil Aviation (Government Entity), King Fahad Specialised Hospital (Government Entity); in addition to non-profit organisations: 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 30 years' professional experience.

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

5. Mr. Khaled bin Saleh Al-Mudaifer (2) (4) (5)
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 32 years' professional experience.

6. Mr. Omar Hadir Al-Farisi (1) (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 23 years' professional experience.

7. Dr. Yahya A. Alyahya (2) (3)
Director since 2015
Chairman, Gulf International Bank (UK) Limited
Kingdom of Saudi Arabia

Dr. Yahya A. Alyahya served as Chief Executive Officer of Gulf International Bank from January 2009 to January 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 currently Chairman of GIBUK Limited; and Saudi Airline Catering Company. Dr. Alyahya was also Chairman of Shuaibah Water and Electricity Company and Shuaibah Expansion Project Company, in Saudi Arabia. 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) at the Institute of International Finance. He is also a Member of the Conciliation and Arbitration Panels of the International Center for Settlement of Investment Disputes (ICSID). 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 41 years' professional experience.

8. Mr. Abdulaziz A. Al-Helaissi (1)
Elected to the Board 30 November 2016
Group Chief Executive Officer, Gulf International Bank
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 Agency (SAMA), having started there in 2013. At SAMA, his responsibilities included oversight of the banking and insurance sectors, as well as finance company regulations (mortgages, leasing and other non-bank finance agreements). He was additionally responsible for consumer protection. Prior to SAMA, Mr. Al-Helaissi was Senior Country Officer and Managing Director, Saudi Arabia 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 has served on a number of boards, including the Saudi Stock Exchange (Tadawul). Mr. Al-Helaissi holds a BA in Economics from the University of Texas, Austin, USA. He has 27 years' professional experience.

Senior management biographies

Abdulaziz A. Al-Helaissi
Board Member & Group Chief Executive Officer
Chairman of Management Committee

Abdulaziz Al-Helaissi has 27 years' banking experience, primarily in the Kingdom of Saudi Arabia. He joined GIB in his current position in February 2016. Prior to this, he held the role of Deputy Governor for Supervision at the Saudi Arabian Monetary Agency (SAMA), from early 2013. At SAMA, his responsibilities included oversight of the banking and insurance sectors, as well as finance company regulations (mortgages, leasing and other non-bank finance agreements). He was additionally responsible for consumer protection. Prior to SAMA, Abdulaziz was Senior Country Officer and Managing Director, Saudi Arabia 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 has served on a number of boards, including the Saudi Stock Exchange (Tadawul). Abdulaziz holds a BA in Economics from the University of Texas, Austin, USA.

Stewart Macphail
Chief Operating Officer
Member of Management Committee, Human Resources Committee, Group Risk Committee, Operational Risk Management Committee and Information Security Committee

Stewart Macphail has over 27 years' international business experience in both financial services and other business sectors, ranging from retail to construction. He joined GIB in his current position in December 2014. Stewart is responsible for Group Operations, Information Technology, Administration Services, Corporate Communications and the Enterprise Programme Management Office; and currently has responsibility for the Bank's retail business. For seven years prior to joining GIB, Stewart held senior executive roles and board memberships across a diverse range of businesses in the MENA region, from large family groups and public companies to private equity-held businesses. In these positions, he operated at a strategic management level, developing restructuring strategies and translating them into clear operational implementation plans. Prior to moving to the Middle East, he worked for over 15 years in Europe with GE Capital, where his final position was CEO of GE Capital's Card Services business in the UK. Stewart holds a BA Honours degree in Business and Law from Lancaster University, UK.

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

Stephen Williams has 32 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 in April 2008. Stephen is responsible for Group-wide statutory, regulatory and management reporting; financial and balance sheet planning; capital management; and Basel 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
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 37 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
Chief Investment & Treasury Officer
Member of Management Committee, Human Resources Committee, Asset and Liabilities Committee, Operational Risk Management Committee and Information Security Committee

Steven Moulder has 36 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 GIBUK Limited. Steven moved to GIB Bahrain in 2009 as Head of Treasury Capital Markets, and was appointed Acting Chief Investment & Treasury Officer in 2005. 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
Chief Human Resources Officer
Member of Management Committee, Human Resources Committee and Information Security Committee

Helen Janet Lloyd has over 31 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 was HR Director - UK and International at RSA Insurance, UK. Previously, Helen was AGM - Organisational Effectiveness at Commercial Bank of Qatar; and Head of HR - Commercial at Lloyds Banking Group, UK. Before this, she worked for 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 (majoring in Psychology and Sociology) from the University of South Africa (UNISA). She attended the Management Development Programme at UNISA School of Business Leadership.

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

Stephen Whitaker has over 23 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 included 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 Head of Compliance & Group MLRO
Board Secretary of the Corporate Governance Committee, Member of Management Committee, Operational Risk Management Committee and Information Security Committee

Yasser Al-Anssari has over 18 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 Agency); a Certified Anti-Money Laundering Specialist (CAMS); and holds two Graduate Diplomas in Anti-Money Laundering and International Compliance from the International Compliance Association.

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

Ravi Krishnan has over 16 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.

Senior management biographies (continued)

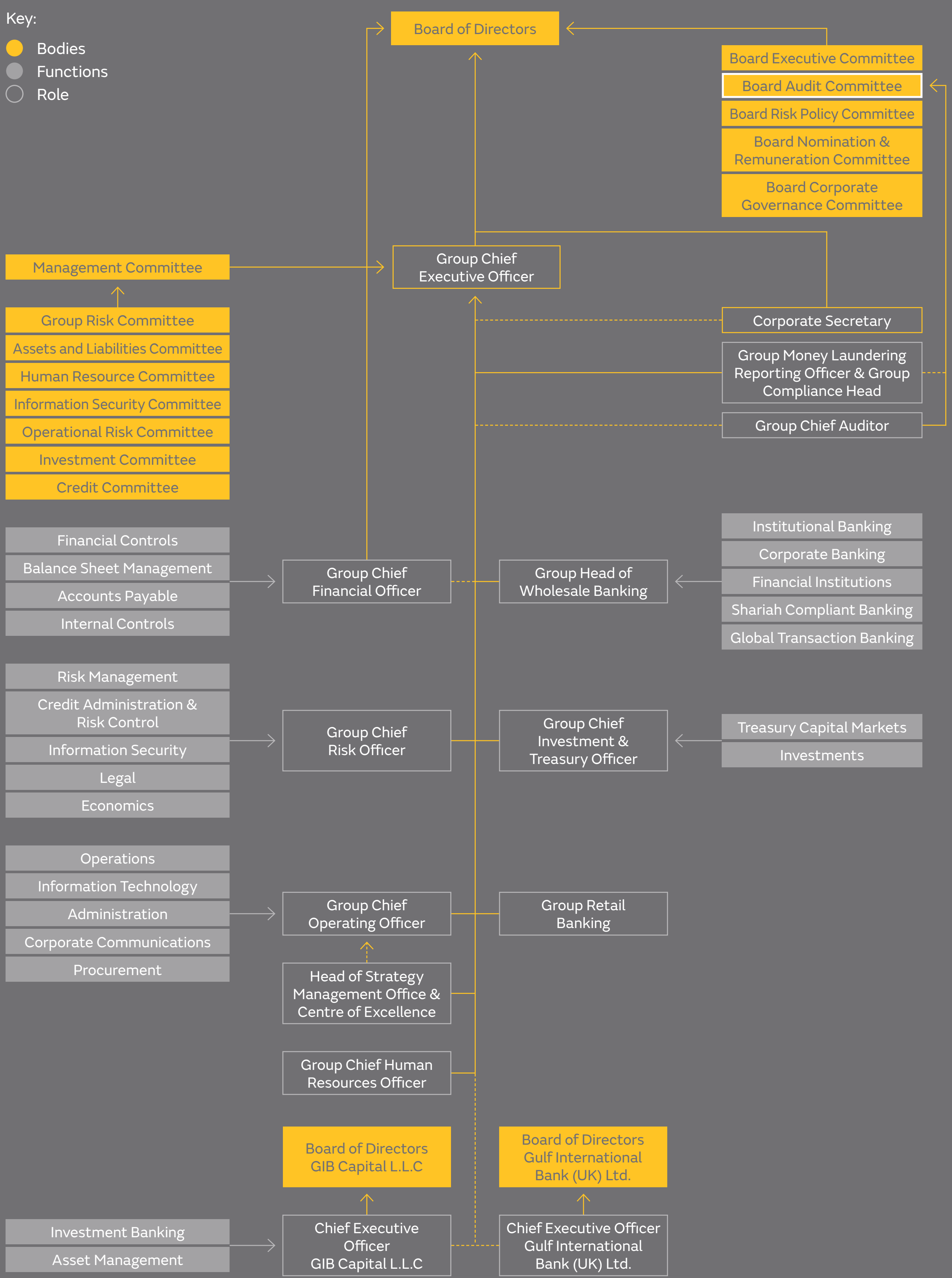
Osamah Mohammed Shaker
Chief Executive Officer - GIB Capital
Member of Management Committee and Human Resources Committee

Osamah Mohammed Shaker has over 18 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 Agency (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. Prior to that he was 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, Fort Collins, Colorado, USA; and a Bachelor of Administrative Sciences degree in Quantitative Methods, from King Saud University, Riyadh, Kingdom of Saudi Arabia.

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

Mushari Al Otaibi has over 25 years' experience in the areas of back office operations, human resources, retail banking and wealth management. He joined GIB in his current position in August 2016, and is responsible for Operations, Operational Improvement and Quality; as well as being the Country Head for Saudi Arabia. Prior to this, Mushari was General Manager - Operations & Processing at the 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.

Organisation and corporate governance chart



One Bank. Three Continents.
Infinite Possibilities.

Consolidated Financial Statements

For the year ended 31st December 2016

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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 2016, 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 2016, 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 2016. 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.

1. Impairment of loans and advances	
Key audit matter	**How the key audit matter was addressed in the audit**
The Group exercises significant judgment using subjective assumptions over both when and how much to record as loan impairment, and estimation of the amount of the impairment provision for loans and advances. Loans and advances form a major portion of the Group's assets, and 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 2016, the Group's gross loans and advances amounted to US$10,166.1 million and the related impairment provisions amounted to US$421.0 million, comprising US$165.5 million of provision against Stage 1 and 2 exposures and US$255.5 million against exposures classified under Stage 3. The impairment provision policy is presented in the accounting policies, and in Note 27 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; ▪ For exposures determined to be individually impaired, we tested a sample of loans and advances and examined management's estimate of future cash flows and checked the resultant provision calculations; and ▪ For provision against exposures classified as Stage 1 and Stage 2 on early adoption of IFRS 9, we obtained an understanding of the Group's provisioning methodology, the underlying assumptions and the sufficiency of the data used by the management. Our procedures in this regard are discussed in further detail below under the key audit matter "Early adoption of IFRS 9".

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)

2. Early adoption of IFRS 9	
Key audit matter	**How the key audit matter was addressed in the audit**
The International Accounting Standards Board issued IFRS 9 – "*Financial Instruments*" which replaces "*IAS 39 – Financial Instruments*" in three phases as follows: **Phase 1** – Classification and measurement of financial assets and financial liabilities; **Phase 2** – Impairment methodology; and **Phase 3** – Hedge accounting. The Group early adopted Phase 1 effective 1 January 2012. During 2016, the Group concluded that subsequent amendments to IFRS 9 on classification and measurement did not materially impact the classification adopted by the Group during 2012. Effective 1 January 2016, the Group has early adopted IFRS 9 (Phases 2 and 3) ahead of its mandatory effective date of 1 January 2018. As allowed by IFRS 9, the impairment requirements have been applied retrospectively without restating comparatives. Differences between previously reported carrying amounts and new carrying amounts of financial instruments as of 31 December 2015 and 1 January 2016 amounting to US$68.7 million have been recognized in the opening retained earnings. The key change arising from early adoption of Phase 2 of IFRS 9 is that the Group's credit losses are now based on an expected loss model rather than an incurred loss model. There were no significant changes arising from the early adoption of hedge accounting requirements under Phase 3 of IFRS 9.	▪ We read the Group's IFRS 9 based impairment provisioning policy and compared it with the requirements of IFRS 9 as well as relevant regulatory guidelines and pronouncements; ▪ We obtained an understanding of the Group's internal rating model for loans and advances and read the rating validation report prepared by an external expert to gain comfort that the discrimination and calibration of the rating model is appropriate. Further, we performed procedures to ensure the competence, objectivity and independence of the external expert; ▪ 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; ▪ 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 the Group's staging; ▪ For a sample of exposures, we checked the appropriateness of determining Exposure at Default, including the consideration of prepayments and 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 Default used by the Group's management in the ECL calculations are those approved by the Group Risk Committee; ▪ 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 2016; ▪ 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;

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)

2. Early adoption of IFRS 9 (continued)	
Key audit matter	**How the key audit matter was addressed in the audit**
	• Where relevant, we used Information System specialists to gain comfort on data integrity; • We assessed the financial statement disclosures arising on early adoption of IFRS 9 to determine if they were in accordance with the requirements of the Standard. 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 27 respectively to the consolidated financial statements; and • For financial instruments exposed to credit risk, as of 1 January 2016, we checked the calculation of the ECL and the transition adjustments.

3. Audit of the opening balances	
Key audit matter	**How the key audit matter was addressed in the audit**
Initial audit engagements involve a number of considerations not associated with recurring audits. Accordingly, additional planning activities and considerations are required to establish an appropriate audit strategy and audit plan. This includes: i) gaining an initial understanding of the Group, its business, its control environment and information systems to make the initial audit risk assessment, develop the audit strategy and the audit plan; and ii) obtaining sufficient appropriate audit evidence on the opening balances, including the selection and application of accounting policies and communication with the previous auditors.	Following our appointment as the Group's auditors for the year ended 31 December 2016, we made inquiries with the predecessor auditor and performed a review of their 2015 audit files at all major locations to obtain sufficient appropriate audit evidence in respect of the opening balances as at 1 January 2016, including evidence with respect to the appropriate selection and application of accounting policies. Additionally, through the following procedures we obtained sufficient information to gain an understanding on which to base our audit strategy and detailed audit plan: • Several meetings were held with the various functional heads of the Group to gain an initial understanding of the Group and its operations, including its control environment and information systems, sufficient to make audit risk assessments and develop the audit strategy and audit plan; and • Attendance at the Group's Audit Committee meetings to understand its perspective on the various risks.

Other information included in the Group's 2016 Annual Report

Other information consists of the information included in the Group's 2016 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.

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

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

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.

- 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.

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)
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.

Other matter
The consolidated financial statements of the Group for the year ended 31 December 2015 were audited by another auditor who expressed an unmodified opinion on those statements on 12 February 2016.

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 2016 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
17 February 2017
Manama, Kingdom of Bahrain

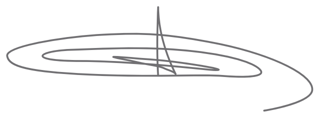
Consolidated statement of financial position

	Note	31.12.16 US$ millions	31.12.15 US$ millions
ASSETS			
Cash and other liquid assets	5	**3,095.0**	4,309.7
Securities purchased under agreements to resell	6	**635.0**	1,835.0
Placements	7	**4,715.3**	4,402.9
Trading securities	8	**91.9**	72.2
Investment securities	9	**4,066.4**	3,884.5
Loans and advances	10	**9,745.1**	9,161.4
Other assets	11	**557.1**	526.7
Total assets		**22,905.8**	24,192.4
LIABILITIES			
Deposits from banks	13	**2,554.2**	1,985.9
Deposits from customers	13	**13,447.5**	14,683.4
Securities sold under agreements to repurchase	14	**1,321.5**	2,093.4
Other liabilities	15	**463.6**	428.7
Senior term financing	16	**2,761.6**	2,420.0
Subordinated term financing	17	**-**	150.0
Total liabilities		**20,548.4**	21,761.4
EQUITY			
Share capital	18	**2,500.0**	2,500.0
Reserves	19	**364.7**	379.8
Retained earnings		**(507.3)**	(448.8)
Total equity		**2,357.4**	2,431.0
Total liabilities & equity		**22,905.8**	24,192.4

The consolidated financial statements were approved by the Board of Directors on 17th February 2017 and signed on its behalf by:-

Jammaz bin Abdullah Al-Suhaimi
Chairman

Abdullah bin Hassan Alabdulgader
Chairman of Board Audit Committee



Abdulaziz A. Al-Helaissi
Chief Executive Officer

The notes on pages 70 to 116 form part of these consolidated financial statements.

Consolidated statement of income

	Note	**Year ended 31.12.16**	Year ended 31.12.15
		US$ millions	US$ millions
Interest income	*21*	**469.0**	344.0
Interest expense	*21*	**279.0**	155.8
Net interest income		**190.0**	188.2
Fee and commission income	*22*	**66.2**	70.2
Foreign exchange income	*23*	**14.4**	19.8
Trading income	*24*	**11.9**	6.2
Other income	*25*	**17.5**	23.6
Total income		**300.0**	308.0
Staff expenses		**136.9**	128.4
Premises expenses		**18.1**	17.5
Other operating expenses		**64.0**	46.2
Total operating expenses		**219.0**	192.1
Net income before provisions and tax		**81.0**	115.9
Provision charge for investment securities	*9*	**(1.3)**	-
Provision charge for loans and advances	*10*	**(38.6)**	(21.3)
Net income before tax		**41.1**	94.6
Taxation charge on overseas activities		**(3.8)**	(4.2)
Net income		**37.3**	90.4

Jammaz bin Abdullah Al-Suhaimi
Chairman

Abdullah bin Hassan Alabdulgader
Chairman of Board Audit Committee

Abdulaziz A. Al-Helaissi
Chief Executive Officer

The notes on pages 70 to 116 form part of these consolidated financial statements.

Consolidated statement of comprehensive income

	Year ended 31.12.16	Year ended 31.12.15
	US$ millions	US$ millions
Net income	**37.3**	90.4
Other comprehensive income:-		
Items that may subsequently be reclassified to consolidated statement of income:-		
Cash flow hedges:-		
- net changes in fair value	**-**	0.3
	-	0.3
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)	**(14.9)**	(26.0)
Remeasurement of defined benefit pension fund	**(27.3)**	15.6
	(42.2)	(10.4)
Total other comprehensive loss	**(42.2)**	(10.1)
Total comprehensive (loss) / income	**(4.9)**	80.3

Consolidated statement of changes in equity

	Note	Share capital	Reserves	Retained earnings	Total
		US$ millions	US$ millions	US$ millions	US$ millions
At 1st January 2016		**2,500.0**	**379.8**	**(448.8)**	**2,431.0**
Transition adjustment on adoption of IFRS 9	*2.1*	**-**	**-**	**(68.7)**	**(68.7)**
At 1st January 2016 - restated		**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**
At 1st January 2015		2,500.0	392.0	(541.3)	2,350.7
Net income for the year		-	-	90.4	90.4
Other comprehensive (loss) / income for the year		-	(25.7)	15.6	(10.1)
Total comprehensive (loss) / income for the year		-	(25.7)	106.0	80.3
Transfer from retained earnings		-	13.2	(13.2)	-
Transfer to retained earnings		-	0.3	(0.3)	-
At 31st December 2015		2,500.0	379.8	(448.8)	2,431.0

The notes on pages 70 to 116 form part of these consolidated financial statements.

Consolidated statement of cash flows

	Note	Year ended 31.12.16	Year ended 31.12.15
		US$ millions	US$ millions
OPERATING ACTIVITIES			
Net income before tax		**41.1**	94.6
Adjustments to reconcile net income to net cash flow from operating activities:-			
Provisions for investment securities		**1.3**	-
Provisions for loans and advances		**38.6**	21.3
Tax paid		**(2.0)**	(4.1)
Realised profits on debt investment securities		**(1.3)**	(2.7)
Amortisation of investment securities		**12.1**	8.4
Amortisation of senior term financing		**-**	0.3
Net decrease / (increase) in statutory deposits with central banks		**20.8**	(59.2)
Net decrease / (increase) in securities purchased under agreements to resell		**1,200.0**	(529.8)
Net (increase) / decrease in placements		**(312.4)**	777.6
Net (increase) / decrease in trading securities		**(19.7)**	0.5
Net increase in loans and advances		**(622.3)**	(1,251.2)
Increase in accrued interest receivable		**(45.5)**	(28.0)
Increase in accrued interest payable		**42.3**	27.0
Net increase in other net assets		**(70.4)**	(30.9)
Net increase in deposits from banks		**568.3**	745.8
Net (decrease) / increase in deposits from customers		**(1,235.9)**	1,785.6
Net (decrease) / increase in securities sold under agreement to repurchase		**(771.9)**	1,475.4
Net cash (outflow) / inflow from operating activities		**(1,156.9)**	3,030.6
INVESTING ACTIVITIES			
Purchase of investment securities		**(1,422.3)**	(1,192.5)
Maturity of investment securities		**1,193.7**	1,220.8
Net cash (outflow) / inflow from investing activities		**(228.6)**	28.3
FINANCING ACTIVITIES			
Net increase / (decrease) in senior term financing		**341.6**	(953.2)
Net decrease in subordinated term financing		**(150.0)**	(327.8)
Net cash inflow / (outflow) from financing activities		**191.6**	(1,281.0)
(Decrease) / increase in cash and cash equivalents		**(1,193.9)**	1,777.9
Cash and cash equivalents at 1st January		**4,117.5**	2,339.6
Cash and cash equivalents at 31st December	5	**2,923.6**	4,117.5

The notes on pages 70 to 116 form part of these consolidated financial statements.

Notes to the consolidated financial statements

For the year ended 31st December 2016

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 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 1,111.

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, except for the early adoption of IFRS 9 (2014) Financial Instruments and IFRS 7 Financial Instruments: Disclosures with effect from 1st January 2016 as referred to below.

IFRS 9 (2014) ***Financial Instruments and IFRS 7 Financial Instruments: Disclosures***

The Group has adopted IFRS 9 (2014) Financial Instruments in advance of its compulsory effective date. The Group has chosen 1st January 2016 as the date of initial application, i.e. the date on which the Group has assessed the requirements of a new expected loss impairment model, hedge accounting, and the revised guidance on the classification and measurement requirements of financial instruments. The Group had previously early adopted IFRS 9 (2010) as of 1st January 2012 and assessed the classification and measurement of its existing financial assets and financial liabilities as of that date. The Group has voluntarily early adopted IFRS 9 (2014), as it is considered to result in the recognition and measurement of financial instruments on a basis that more appropriately reflects the operations and performance of the Group.

The standard has been applied retrospectively and, in line with IFRS 9, comparative amounts have not been restated. The impact of the early adoption of IFRS 9 as at 1st January 2016 has been recognised in retained earnings. The standard eliminates the use of the existing IAS 39 incurred loss impairment model approach, uses the revised hedge accounting framework, and the revised guidance on the classification and measurement requirements.

IFRS 9 (2014) provides revised guidance on how an entity should classify and measure its financial assets and financial liabilities. IFRS 9 requires all financial assets to be classified in their entirety on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets. The Group reviewed and assessed the classification and measurement of financial assets and financial liabilities on the adoption of IFRS 9 (2010) and has further reviewed and assessed the existing financial assets and financial liabilities at the date of the initial application on 1st January 2016. There have been no changes in the classification and measurement of financial assets or financial liabilities on the adoption of IFRS 9 (2014). The classification bases are set out in note 2.4.

IFRS 9 (2014) replaces the incurred loss model in IAS 39 Financial Instruments: Recognition and Measurement with an expected credit loss model. The new impairment model also applies to certain loan commitments, financial guarantee contracts, and placements, but not to equity investments. If a financial asset had low credit risk at the date of initial application of IFRS 9, then the credit risk of the asset has been deemed to have not increased significantly since its initial recognition. Under IFRS 9, credit losses are recognised earlier than under IAS 39. The impairment bases are set out in note 2.5.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

2. Accounting policies (continued)

2.1 Basis of preparation (continued)
The impact of this change in accounting policy as at 1st January 2016 has been to decrease retained earnings by US$68.7 million as follows:-

	Retained earnings
	US$ millions
Due to the change in the impairment model for financial assets:-	
Placements	-
Investment securities (IAS 39: US$3.2 million, IFRS 9: US$3.2 million)	-
Loans and advances (IAS 39: US$361.0 million, IFRS 9: US$429.7 million)	**(68.7)**
	(68.7)

If IFRS 9 had not been adopted, the consolidated statement of income for the year ended 31st December 2016 would have been impacted by a decrease in net income of US$15.8 million resulting from the use of the incurred loss methodology to calculate impairment losses on financial assets, which would not have been offset by the retained earnings adjustment of US$68.7 million as noted above.

No incremental adjustment was necessary to reflect the transition from an incurred loss model to an expected credit loss model for placements, due to the short tenor and the high credit quality of the placement counterparties.

Additional disclosures, as required by IFRS 7, reflecting the revised impairment model for financial assets of the Group as a result of adopting IFRS 9, are disclosed in relevant notes throughout the consolidated financial statements.

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).

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

2. Accounting policies (continued)

2.4 Financial assets and liabilities (continued)

a) Recognition and measurement (continued)

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.

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 2016

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 they 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.

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 2016

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 programmes 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 2016

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 or insurance plans. The Group also pays contributions to Government defined contribution pension plans in accordance with the legal requirements in each location.

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

The calculation of obligations in respect of the defined benefit pension plan is performed by a qualified actuary 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 plan or reductions in future contributions.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

2. Accounting policies (continued)

2.13 Post retirement benefits (continued)

Remeasurements of the net defined benefit liability or asset, which comprises 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 plan 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 a defined benefit plan 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).

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

2. Accounting policies (continued)

2.20 Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year, with the exception of the adoption of IFRS 9. The following accounting policies were applicable for the year ended 31st December 2015:-

Provisions for 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 impairment are also measured and recognised on a collective basis in respect of impairments that exist at the balance sheet date but which will only be individually identified in the future. Future cash flows for financial assets that are collectively assessed for impairment are estimated based on contractual cash flows and historical loss experiences for assets with similar credit risk characteristics. Historical loss experience is adjusted, based on current observable data, to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based.

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

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

Provisions for impairment are released and transferred to the consolidated statement of income where the subsequent increase in the recoverable amount is related objectively to an event occurring after the provision for impairment was established.

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 2016. 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. The Group is assessing the potential impact on its consolidated financial statements resulting from the application of this standard. IFRS 15 is effective for annual periods beginning on or after 1st January 2018.

- 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.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

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 plan, 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 27.1.

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 an independent qualified actuary, are required to make assumptions regarding the defined benefit pension plan. The principal actuarial assumptions for the defined benefit pension plan 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.

The principal investment funds are set out in note 35.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

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 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**
Equity	**-**	**-**	**-**	**-**	**2,357.4**	**2,357.4**
Total liabilities & equity	**-**	**132.2**	**-**	**20,330.9**	**2,442.7**	**22,905.8**
At 31st December 2015						
Cash and other liquid assets	4,309.7	-	-	-	-	4,309.7
Securities purchased under agreements to resell	1,835.0	-	-	-	-	1,835.0
Placements	4,402.9	-	-	-	-	4,402.9
Trading securities	-	72.2	-	-	-	72.2
Investment securities	3,612.6	-	271.9	-	-	3,884.5
Loans and advances	9,161.4	-	-	-	-	9,161.4
Other assets	197.9	172.6	-	-	156.2	526.7
Total assets	23,519.5	244.8	271.9	-	156.2	24,192.4
Deposits from banks	-	-	-	1,985.9	-	1,985.9
Deposits from customers	-	-	-	14,683.4	-	14,683.4
Securities sold under agreements to repurchase	-	-	-	2,093.4	-	2,093.4
Other liabilities	-	176.8	-	183.0	68.9	428.7
Senior term financing	-	-	-	2,420.0	-	2,420.0
Subordinated term financing	-	-	-	150.0	-	150.0
Equity	-	-	-	-	2,431.0	2,431.0
Total liabilities & equity	-	176.8	-	21,515.7	2,499.9	24,192.4

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 31.4.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

5. Cash and other liquid assets

	31.12.16	31.12.15
	US$ millions	US$ millions
Cash and balances with central banks	2,311.7	3,605.9
Cash and balances with banks	405.0	471.7
Government bills	206.9	39.9
Cash and cash equivalents	2,923.6	4,117.5
Statutory deposits with central banks	171.4	192.2
Cash and other liquid assets	3,095.0	4,309.7

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 2016 included placements with central banks amounting to US$1,212.7 million (2015: US$1,085.8 million). The placements with central banks represented the placement of surplus liquid funds.

8. Trading securities

	31.12.16	31.12.15
	US$ millions	US$ millions
Managed funds	66.6	47.6
Debt securities	13.1	13.1
Equity securities	12.2	11.5
	91.9	72.2

Equity and debt 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.

Managed funds comprised funds placed for investment with specialist managers.

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:-

	31.12.16		31.12.15	
	US$ millions	%	US$ millions	%
AAA to A- / Aaa to A3	3,292.1	86.3	3,088.1	85.5
BBB+ to BBB- / Baa1 to Baa3	310.9	8.1	514.0	14.2
BB+ to BB- / Ba1 to Ba3	212.3	5.6	10.5	0.3
Total debt securities	3,815.3	100.0	3,612.6	100.0
Equity investments	251.1		271.9	
	4,066.4		3,884.5	

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.

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

The decrease in the investment securities rated BBB+ to BBB- / Baa1 to Baa3 and the increase in the investment securities rated BB+ to BB- / Ba1 to Ba3 during the year ended 31st December 2016 were principally attributable to the downgrade of certain GCC sovereign ratings.

9.2 Provisions for impairment

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

	Collective provision		Specific provision	2016	2015
	Stage 1	Stage 2	Stage 3	Total	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January	**3.2**	-	-	**3.2**	3.2
Transition adjustment on adoption of IFRS 9	-	-	-	-	-
At 1st January - restated	**3.2**	-	-	**3.2**	3.2
Net remeasurement of loss allowance	**1.3**	-	-	**1.3**	-
At 31st December	**4.5**	-	-	**4.5**	3.2

Comparative amounts for the year ended 31st December 2015 represent provisions for impairment and reflect the measurement basis under IAS 39. The opening expected credit loss (ECL) allowance as at 1st January 2016 is determined by remeasuring the ECL allowance in accordance with IFRS 9.

10. Loans and advances

10.1 Composition

	31.12.16	31.12.15
	US$ millions	US$ millions
Gross loans and advances	**10,166.1**	9,522.4
Provisions for impairment	**(421.0)**	(361.0)
Net loans and advances	**9,745.1**	9,161.4

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

10. Loans and advances (continued)

10.2 Industrial classification

	31.12.16	31.12.15
	US$ millions	US$ millions
Trading and services	**2,203.6**	2,100.6
Energy, oil and petrochemical	**2,044.8**	1,986.5
Financial	**1,958.6**	1,861.7
Transportation	**1,278.1**	1,087.4
Manufacturing	**1,100.6**	917.7
Construction	**688.3**	765.2
Agriculture and mining	**223.8**	130.3
Real estate	**188.7**	280.9
Communication	**183.0**	273.5
Government	**113.4**	0.1
Other	**183.2**	118.5
	10,166.1	9,522.4
Provisions for impairment	**(421.0)**	(361.0)
	9,745.1	9,161.4

Gross loans at 31st December 2016 included Shariah-compliant transactions amounting to US$3,591.9 million (2015: US$3,268.0 million).

10.3 Provisions for impairment

	Collective provision		Specific provision	2016			2015
	Stage 1	Stage 2	Stage 3	Total	Collective provision	Specific provision	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 1st January				**361.0**	148.0	453.1	601.1
Transition adjustment on adoption of IFRS 9				**68.7**	-	-	-
At 1st January - restated	**76.2**	**127.0**	**226.5**	**429.7**	148.0	453.1	601.1
Transfer to stage 1	**11.1**	**(0.4)**	**(10.7)**	**-**	-	-	-
Transfer to stage 2	**(4.2)**	**4.2**	**-**	**-**	-	-	-
Transfer to stage 3	**(0.2)**	**(47.5)**	**47.7**	**-**	-	-	-
Amounts reallocated	**-**	**-**	**-**	**-**	(13.5)	13.5	-
Amounts utilised	**-**	**-**	**(46.0)**	**(46.0)**	-	(261.0)	(261.0)
Exchange rate movements	**-**	**-**	**(1.3)**	**(1.3)**	-	(0.4)	(0.4)
Net remeasurement of loss allowance	**(0.4)**	**(0.3)**	**39.3**	**38.6**	-	21.3	21.3
At 31st December	**82.5**	**83.0**	**255.5**	**421.0**	134.5	226.5	361.0

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.

The gross amount of stage 3 loans at 31st December 2016 was US$367.2 million (2015: US$238.8 million). Total stage 3 provisions at 31st December 2016 represented 69.6 per cent of loans against which a provision had been made (2015: total specific provisions represented 94.8 per cent of loans against which a provision had been made).

The increase in the gross carrying amount of loans and advances during the year ended 31st December 2016 did not have a material impact on the changes in the expected credit losses.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

10. Loans and advances (continued)

10.3 Provisions for impairment (continued)

Amounts utilised during the years ended 31st December 2016 and 31st December 2015 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 2016 included US$18.7 million of provisions in relation to credit-related contingent exposures (2015: US$8.0 million).

Comparative amounts for 2015 represent provisions for impairment and reflect the measurement basis under IAS 39.

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:-

	31.12.16 Gross	**31.12.16 Carrying Amount**	31.12.15 Gross	31.12.15 Carrying Amount
	US$ millions	**US$ millions**	US$ millions	US$ millions
Corporates	**328.6**	**84.2**	212.2	33.1
Financial institutions	**10.7**	**9.8**	12.9	5.6
	339.3	**94.0**	225.1	38.7

Corporates include loans extended for investment purposes.

At 31st December 2016, total specific provisions against past due loans represented 72.3 per cent of gross past due loans (2015: 82.8 per cent)

10.5 Restructured and modified loans

During the year ended 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.

During the year ended 31st December 2016, the Group did not restructure any loan or make any concessions that would not ordinarily have been accepted due to a deterioration in the customer's financial position (2015: two loans amounting to US$20.3 million). The nature of modifications is set out in note 27.1.

10.6 Collateral

The Group did not take possession of any collateral during the years ended 31st December 2016 and 31st December 2015.

11. Other assets

	31.12.16	31.12.15
	US$ millions	US$ millions
Derivative financial instruments	**168.9**	172.6
Accrued interest, fees and commissions	**167.1**	121.6
Premises and equipment	**122.3**	118.6
Prepayments	**29.0**	35.2
Deferred items	**8.4**	2.4
Prepaid pension cost	**-**	13.0
Other, including accounts receivable	**61.4**	63.3
	557.1	526.7

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 31.4.

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

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 defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined benefit and defined contribution pension plans for the year ended 31st December 2016 amounted to US$13.5 million (2015: US$10.8 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a 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:-

	31.12.16	31.12.15
	US$ millions	US$ millions
Fair value of plan assets	**190.1**	203.8
Present value of fund obligations	**203.9**	190.8
Net (liability) / asset in the consolidated statement of financial position	**(13.8)**	13.0

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 21 years.

The movement in the valuation measure from an asset to a liability during the year ended 31st December 2016 was primarily due to the sharp decline in the discount rate used in the mathematical model to discount the plan's future obligations over a duration of 21 years. The impact of this financial assumption is presented in note 12.3.

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

	2016	2015
	US$ millions	US$ millions
At 1st January	**203.8**	214.5
Included in the consolidated statement of income:-		
- Interest income on the plan assets	**6.6**	7.1
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements:-		
- Return on plan assets excluding interest income	**15.2**	(2.0)
Other movements:-		
- Exchange rate movements	**(30.2)**	(12.0)
- Contributions paid by the Group	**0.6**	0.7
- Benefits paid by the plan	**(5.9)**	(4.5)
At 31st December	**190.1**	203.8

The plan assets at 31st December 2016 comprised a 42 per cent (2015: 50 per cent) exposure to multi-asset funds, with the balance exposure to equities, debt and hedging funds in equal proportion. 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 2016

12. Post retirement benefits (continued)

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

	2016	2015
	US$ millions	US$ millions
At 1st January	190.8	216.8
Included in the consolidated statement of income:-		
- Current service cost	0.7	0.9
- Interest cost on the fund obligations	6.1	7.2
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Financial assumptions	40.9	(11.6)
- Experience	(0.3)	(6.0)
Other movements:-		
- Exchange rate movements	(28.4)	(12.0)
- Benefits paid by the plan	(5.9)	(4.5)
At 31st December	**203.9**	190.8

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

	2016	2015
	US$ millions	US$ millions
At 1st January	13.0	(2.3)
Net expense included in consolidated statement of income	(0.2)	(1.0)
Remeasurement included in consolidated statement of comprehensive income	(27.3)	15.6
Contributions paid by the Group	0.7	0.7
At 31st December	**(13.8)**	13.0

The Group paid US$0.7 million in contributions to the plan during 2016 and expects to pay US$0.7 million during 2017.

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

	2016	2015
Discount rate (per cent)	2.8	3.9
Retail price inflation (per cent)	3.3	3.1
Consumer price inflation (per cent)	2.3	2.1
Pension increase rate (per cent)	3.2	3.1
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 2016

12. Post retirement benefits (continued)

12.6 Sensitivity information

The present value of the fund's obligations, which has a weighted average duration of 21 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:-

	2016	2015
	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
Salary growth rate increased by 0.5 per cent	**0.2**	0.2

13. Deposits

The geographical composition of total deposits was as follows:-

	31.12.16	31.12.15
	US$ millions	US$ millions
GCC countries	**10,387.7**	11,749.6
Other Middle East and North Africa countries	**1,102.6**	777.3
Other countries	**4,511.4**	4,142.4
	16,001.7	16,669.3

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 2016, GCC deposits represented 64.9 per cent of total deposits (2015: 70.5 per cent).

Total deposits at 31st December 2016 included Shariah-compliant transactions amounting to US$3,265.4 million (2015: US$4,112.0 million). Shariah-compliant transactions comprise murabaha contracts.

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 2016, the fair value of investment securities that had been pledged as collateral under repurchase agreements was US$1,360.0 million (2015: US$2,192.0 million). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

15. Other liabilities

	31.12.16	31.12.15
	US$ millions	US$ millions
Accrued interest	**138.1**	95.8
Derivative financial instruments	**132.2**	176.8
Deferred items	**85.3**	68.9
Pension liability	**13.8**	-
Other, including accounts payable and accrued expenses	**94.2**	87.2
	463.6	428.7

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

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 31.4.

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

16. Senior term financing

	Maturity	31.12.16	31.12.15
		US$ millions	US$ millions
Floating rate note	2017	499.9	499.9
Floating rate loans	2018	673.9	615.0
Floating rate note	2019	533.1	533.3
Floating rate loans	2019 - 2022	521.6	271.8
Floating rate note	2021	533.1	-
Floating rate loan	2016	-	500.0
		2,761.6	2,420.0

The US$500.0 million floating rate loan that matured in 2016 was provided by the Group's majority shareholder, the Public Investment Fund. The loan was based on market rates and standardised terms that are usual and customary for such transactions.

17. Subordinated term financing

	Maturity	31.12.16	31.12.15
		US$ millions	US$ millions
Floating rate loans	2016	-	150.0

The subordinated term financing facilities as at 31st December 2015 represent unsecured obligations of the Group and were subordinated in right of payment to the claims of depositors and other creditors of the Group that were not also subordinated. The subordinated financing facilities were approved for inclusion in tier 2 capital for capital adequacy purposes by the Bank's regulator, the Central Bank of Bahrain.

18. Share capital

The authorised share capital at 31st December 2016 comprised 3.0 billion shares of US$1 each (2015: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2016 comprised 2.5 billion shares of US$1 each (2015: 2.5 billion shares of US$1 each). All issued shares are fully paid.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

19. 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 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**
At 1st January 2015	7.6	214.1	151.6	(0.3)	19.0	392.0
Net fair value gains on cash flow hedges	-	-	-	0.3	-	0.3
Net fair value losses on equity investments classified as FVTOCI	-	-	-	-	(26.0)	(26.0)
Transfers to retained earnings	-	-	-	-	0.3	0.3
Net (decrease) / increase	-	-	-	0.3	(25.7)	(25.4)
Transfers from retained earnings	-	6.6	6.6	-	-	13.2
At 31st December 2015	7.6	220.7	158.2	-	(6.7)	379.8

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.

20. Dividends

No dividend is proposed in respect of the financial years ended 31st December 2016 and 31st December 2015.

21. Net interest income

	Year ended 31.12.16	Year ended 31.12.15
	US$ millions	US$ millions
Interest income		
Placements and other liquid assets	**57.0**	48.1
Investment securities	**70.6**	60.7
Loans and advances	**341.4**	235.2
Total interest income	**469.0**	344.0
Interest expense		
Deposits from banks and customers	**196.0**	94.9
Securities sold under agreements to repurchase	**14.5**	8.2
Term financing	**68.5**	52.7
Total interest expense	**279.0**	155.8
Net interest income	**190.0**	188.2

The increases in interest income and interest expense are principally due to higher interest rates within the Group's core market in the GCC.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

21. Net interest income (continued)

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

Accrued interest on impaired and past due loans included in interest income for the year ended 31st December 2016 amounted to nil (2015: 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 2016 or 31st December 2015.

22. Fee and commission income

	Year ended 31.12.16	Year ended 31.12.15
	US$ millions	US$ millions
Fee and commission income		
Investment banking and management fees	**33.0**	38.3
Commissions on letters of credit and guarantee	**29.0**	28.6
Loan commitment fees	**3.1**	2.1
Other fee and commission income	**2.4**	2.6
Total fee and commission income	**67.5**	71.6
Fee and commission expense	**(1.3)**	(1.4)
Net fee and commission income	**66.2**	70.2

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 2016 included fee income relating to the Group's fiduciary activities amounting to US$23.2 million (2015: US$23.5 million).

Fee and commission expense principally comprises security custody fees.

23. 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.

24. Trading income

	Year ended 31.12.16	Year ended 31.12.15
	US$ millions	US$ millions
Interest rate derivatives	**8.8**	2.8
Managed funds	**2.1**	3.6
Equity securities	**0.7**	(0.3)
Commodity options	**0.2**	0.1
Debt securities	**0.1**	-
	11.9	6.2

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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

25. Other income

	Year ended 31.12.16	Year ended 31.12.15
	US$ millions	US$ millions
Recoveries on previously written off assets	**8.8**	7.9
Dividends on equity investments classified as FVTOCI	**7.3**	12.6
Net realised profits on investment debt securities	**1.3**	2.7
Sundry income	**0.1**	0.4
	17.5	23.6

The decrease in dividends on equity investments reflects a timing difference in the declaration of the dividends.

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

26. 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.

26.1 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, and the provision of financial advisory services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.

- Treasury: the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary investment and trading activities and the management of the Group's balance sheet, including funding.

- Financial markets: the provision of asset and fund management services.

- 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 senior and subordinated 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 2016

26. Segmental information (continued)

26.1 Business segments (continued)

The business segment analysis is as follows:-

	Wholesale banking	Treasury	Financial markets	Head office and support units	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
2016					
Net interest income	**101.8**	**69.6**	**-**	**18.6**	**190.0**
Total income	**157.3**	**94.9**	**24.5**	**23.3**	**300.0**
Segment result	**48.7**	**84.4**	**16.5**	**(108.5)**	**41.1**
Taxation charge on overseas activities					**(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**	**26.1**	**2,859.9**	**20,548.4**
Total equity					**2,357.4**
Total liabilities and equity					**22,905.8**
2015					
Net interest income	94.6	62.7	-	30.9	188.2
Total income	145.0	90.4	25.2	47.4	308.0
Segment result	80.3	79.5	17.9	(83.1)	94.6
Taxation charge on overseas activities					(4.2)
Net income after tax					90.4
Segment assets	9,334.3	14,462.2	51.2	344.7	24,192.4
Segment liabilities	-	19,100.8	11.1	2,649.5	21,761.4
Total equity					2,431.0
Total liabilities and equity					24,192.4

26.2 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:-

	2016 Total income	2016 Total assets	2015 Total income	2015 Total assets
	US$ millions	US$ millions	US$ millions	US$ millions
GCC	**231.2**	**17,066.6**	247.7	16,881.0
Other countries	**68.8**	**5,839.2**	60.3	7,311.4
	300.0	**22,905.8**	308.0	24,192.4

The geographical analyses of deposits and risk assets are set out in notes 13 and 28 respectively.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

27. 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:-

27.1 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 or since the date of the last annual review, 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 2016

27. Risk management (continued)

27.1 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 Group 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 Bank's 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 2016

27. Risk management (continued)

27.1 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 1st January 2016 and 31st December 2016, the probabilities assigned to the base case, negative case and positive case scenarios were in the ratio of 60:20:20 respectively.

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:-

	31.12.16	31.12.15
	US$ millions	US$ millions
Balance sheet items:		
Cash and other liquid assets	**3,095.0**	4,309.7
Securities purchased under agreements to resell	**635.0**	1,835.0
Placements	**4,715.3**	4,402.9
Trading securities	**91.9**	72.2
Investment securities	**4,066.4**	3,884.5
Loans and advances	**9,745.1**	9,161.4
Accrued interest receivable	**167.1**	121.6
Total on-balance sheet credit exposure	**22,515.8**	23,787.3
Off-balance sheet items:		
Credit-related contingent items	**4,296.6**	4,462.4
Foreign exchange-related items	**110.4**	239.7
Derivative-related items	**110.8**	34.2
Commodity contracts	**2.4**	1.1
Total off-balance sheet credit exposure	**4,520.2**	4,737.4
Total gross credit exposure	**27,036.0**	28,524.7

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

27. Risk management (continued)

27.1 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 2016

27. Risk management (continued)

27.1 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	31.12.16 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
Carrying amount (net)	8,445.3	3,815.3	8,985.9	4,120.4
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	3,815.3	9,745.1	4,293.5

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 largely related to a past due but not impaired loan exposure guaranteed by a government export credit agency.

The 7-rated stage 3 exposure related to a loan facility that had been restructured and has subsequently performed in accordance with the terms of the restructuring agreement.

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

27. Risk management (continued)

27.1 Credit risk (continued)

b) Credit risk profile (continued)

31.12.15	Placements, reverse repos & other liquid assets	Securities	Loans and advances	Credit-related contingent items
	US$ millions	US$ millions	US$ millions	US$ millions
Neither past due nor impaired				
Rating grades 1 to 4-	10,427.6	3,625.7	5,243.6	2,336.6
Rating grades 5+ to 5-	120.0	-	3,328.2	2,314.5
Rating grades 6+ to 6-	-	-	540.8	51.0
Rating grade 7	-	-	-	7.3
Carrying amount (net)	10,547.6	3,625.7	9,112.6	4,709.4
Past due but not impaired				
Rating grades 1 to 7	-	-	6.5	
Carrying amount (net)	-	-	6.5	-
Past due and individually impaired				
Rating grade 7	-	-	0.7	13.0
Rating grade 9	-	-	31.5	11.8
Carrying amount (net)	-	-	32.2	24.8
Individually impaired but not past due				
Rating grade 9	-	-	10.1	-
Carrying amount (net)	-	-	10.1	-
	10,547.6	3,625.7	9,161.4	4,734.2

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

Provisions for impairment	-	(3.2)	(361.0)	-

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 2016 or 31st December 2015.

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

An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31 while the notional and risk-weighted exposures for off-balance sheet credit-related financial instruments are set out in note 32.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

27. Risk management (continued)

27.1 Credit risk (continued)

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 28. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31.

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.

27.2 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 31.

The VaR for the Group's trading positions, as calculated in accordance with the basis set out in note 34, was as follows:-

				2016				2015
	31.12.16	**Average**	**High**	**Low**	31.12.15	Average	High	Low
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	US$ millions	US$ millions	US$ millions	US$ millions
Total VaR	**0.4**	**0.2**	**0.5**	**-**	0.7	0.9	1.3	0.7
Total undiversified stressed VaR	**0.6**	**0.3**	**0.9**	**0.1**	1.5	1.7	2.3	1.4

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

27. Risk management (continued)

27.2 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 30. 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 31.5.

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

27.3 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 2016

27. Risk management (continued)

27.3 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 29. An analysis of debt investment securities by rating classification is set out in note 27.1.

27.4 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.

27.5 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 34, 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 2016

27. Risk management (continued)

27.5 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 2016 and 31st December 2015.

There have been no material changes in the Group's management of capital during the years ended 31st December 2016 and 31st December 2015.

The capital adequacy ratio calculation is set out in note 34.

28. Geographical distribution of risk assets

					31.12.16	31.12.15
	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	**2,766.8**	**2,177.8**	**9,529.3**	**3,804.4**	**18,278.3**	17,769.1
Other Middle East & North Africa	**0.1**	**-**	**15.2**	**12.1**	**27.4**	136.4
Europe	**5,100.5**	**889.9**	**128.2**	**186.0**	**6,304.6**	8,141.5
North America	**397.4**	**608.4**	**30.8**	**249.9**	**1,286.5**	1,688.0
Asia	**180.5**	**469.6**	**41.6**	**44.2**	**735.9**	367.0
Latin America	**-**	**12.6**	**-**	**-**	**12.6**	26.1
	8,445.3	**4,158.3**	**9,745.1**	**4,296.6**	**26,645.3**	28,128.1

At 31st December 2016, risk exposures to customers and counterparties in the GCC represented 68.4 per cent (2015: 63.2 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 31.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

29. 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 2016						
Cash and other liquid assets	**3,080.3**	-	-	-	**14.7**	**3,095.0**
Securities purchased under agreements to resell	**535.0**	**100.0**	-	-	-	**635.0**
Placements	**3,563.0**	**1,102.3**	**50.0**	-	-	**4,715.3**
Trading securities	-	-	-	**13.1**	**78.8**	**91.9**
Investment securities	**310.4**	**483.8**	**1,435.8**	**693.4**	**1,143.0**	**4,066.4**
Loans and advances	**3,437.8**	**1,895.7**	**2,304.0**	**1,185.5**	**922.1**	**9,745.1**
Other assets	**208.4**	**95.3**	**41.2**	**10.4**	**201.8**	**557.1**
Total assets	**11,134.9**	**3,677.1**	**3,831.0**	**1,902.4**	**2,360.4**	**22,905.8**
Deposits	**12,540.8**	**3,457.1**	**3.8**	-	-	**16,001.7**
Securities sold under agreements to repurchase	**983.4**	**338.1**	-	-	-	**1,321.5**
Other liabilities	**155.7**	**76.2**	**32.6**	**8.2**	**190.9**	**463.6**
Term financing	-	**499.9**	**1,723.4**	**533.1**	**5.2**	**2,761.6**
Equity	-	-	-	-	**2,357.4**	**2,357.4**
Total liabilities & equity	**13,679.9**	**4,371.3**	**1,759.8**	**541.3**	**2,553.5**	**22,905.8**
At 31st December 2015						
Total assets	12,387.4	4,374.6	3,610.9	1,979.8	1,839.7	24,192.4
Total liabilities & equity	14,991.8	4,563.0	1,198.0	842.6	2,597.0	24,192.4

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 2016

29. 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 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**
At 31st December 2015					
Deposits	13,137.6	3,730.3	4.3	-	-
Securities sold under agreements to repurchase	1,324.8	775.7	-	-	-
Term financing	517.5	194.8	1,192.2	804.1	5.4
Derivative financial instruments					
- contractual amounts payable	58.0	133.0	192.0	80.1	48.6
- contractual amounts receivable	(56.0)	(83.7)	(159.0)	(45.7)	(18.4)
Total undiscounted financial liabilities	14,981.9	4,750.1	1,229.5	838.5	35.6

Information on the contractual terms for the drawdown of gross loan commitments is set out in note 32.

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 31.3.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

30. 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 2016						
Cash and other liquid assets	3,080.3	-	-	-	14.7	3,095.0
Securities purchased under agreements to resell	535.0	-	100.0	-	-	635.0
Placements	3,612.9	784.3	318.1	-	-	4,715.3
Trading securities	-	13.1	-	-	78.8	91.9
Investment securities						
- Fixed rate	173.1	50.1	219.9	975.0	-	1,418.1
- Floating rate	1,364.9	1,036.8	-	-	(4.5)	2,397.2
- Equities	-	-	-	-	251.1	251.1
Loans and advances	8,132.9	1,736.6	41.1	-	(165.5)	9,745.1
Other assets	-	-	-	-	557.1	557.1
Total assets	**16,899.1**	**3,620.9**	**679.1**	**975.0**	**731.7**	**22,905.8**
Deposits	12,540.8	2,099.1	1,358.0	3.8	-	16,001.7
Securities sold under agreements to repurchase	983.4	338.1	-	-	-	1,321.5
Other liabilities	-	-	-	-	463.6	463.6
Term financing	2,761.6	-	-	-	-	2,761.6
Equity	-	-	-	-	2,357.4	2,357.4
Total liabilities & equity	**16,285.8**	**2,437.2**	**1,358.0**	**3.8**	**2,821.0**	**22,905.8**
Interest rate sensitivity gap	**613.3**	**1,183.7**	**(678.9)**	**971.2**	**(2,089.3)**	**-**
Cumulative interest rate sensitivity gap	**613.3**	**1,797.0**	**1,118.1**	**2,089.3**	**-**	**-**
At 31st December 2015						
Cumulative interest rate sensitivity gap	916.2	1,345.2	801.7	2,126.8	-	-

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 2016, the modified duration of these fixed rate securities was 2.14. 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$209,000.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

30. Interest rate risk (continued)

Based on the repricing profile at 31st December 2016, 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$6.5 million and an increase in the Group's equity by US$6.6 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 27. The market risk relating to derivative and foreign exchange instruments classified as FVTPL is set out in note 31.

31. 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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

31. Derivatives and foreign exchange instruments (continued)

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

The Group buys and sells credit protection through credit default swaps. Credit default swaps provide protection against the decline in value of a referenced asset as a result of credit events such as default or bankruptcy. It is similar in structure to an option whereby the purchaser pays a premium to the seller of the credit default swap in return for payment related to the deterioration in value of the referenced asset. Credit default swaps purchased and sold by the Group are classified as derivative financial instruments.

31.1 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 2016				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	**5,549.7**	**-**	**5,549.7**	**94.9**
Options purchased	**1,840.3**	**-**	**1,840.3**	**15.5**
Options written	**1,840.3**	**-**	**1,840.3**	**-**
	9,230.3	**-**	**9,230.3**	**110.4**
Interest rate contracts:-				
Interest rate swaps	**2,814.1**	**12,104.2**	**14,918.3**	**85.4**
Cross currency swaps	**1,159.6**	**-**	**1,159.6**	**-**
Options, caps and floors purchased	**257.2**	**-**	**257.2**	**25.4**
Options, caps and floors written	**257.2**	**-**	**257.2**	**-**
	4,488.1	**12,104.2**	**16,592.3**	**110.8**
Commodity contracts:-				
Options and swaps purchased	**49.3**	**-**	**49.3**	**2.4**
Options and swaps written	**49.3**	**-**	**49.3**	**-**
	98.6	**-**	**98.6**	**2.4**
	13,817.0	**12,104.2**	**25,921.2**	**223.6**
At 31st December 2015	8,858.1	16,265.1	25,123.2	275.0

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

At 31st December 2016, the Value-at-Risk of the foreign exchange, interest rate and commodity trading contracts analysed in the table above was US$0.3 million, US$0.1 million and nil respectively (2015: US$0.1 million, nil 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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

31. Derivatives and foreign exchange instruments (continued)

31.2 Counterparty analysis

	Banks	Corporates	31.12.16 Total	31.12.15 Total
	US$ millions	US$ millions	US$ millions	US$ millions
OECD countries	129.4	35.5	164.9	225.2
GCC countries	5.7	53.0	58.7	49.8
	135.1	88.5	223.6	275.0

Credit risk is concentrated on major OECD-based banks.

31.3 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 2016					
Foreign exchange contracts	8,074.3	1,156.0	-	-	9,230.3
Interest rate contracts	9,743.2	3,816.9	937.6	2,094.6	16,592.3
Commodity contracts	32.9	38.4	27.3	-	98.6
	17,850.4	5,011.3	964.9	2,094.6	25,921.2
At 31st December 2015	18,230.3	4,998.9	1,346.7	547.3	25,123.2

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.

31.4 Fair value analysis

	31.12.16 Positive fair value	31.12.16 Negative fair value	31.12.15 Positive fair value	31.12.15 Negative fair value
	US$ millions	US$ millions	US$ millions	US$ millions
Derivatives classified as FVTPL:-				
Foreign exchange contracts	52.7	(53.4)	120.6	(118.6)
Interest rate contracts	85.4	(75.8)	43.5	(40.5)
Commodity contracts	3.0	(3.0)	8.5	(8.5)
	141.1	(132.2)	172.6	(167.6)
Derivatives held as fair value hedges:-				
Interest rate contracts	27.8	-	-	(9.2)
Amount included in other assets / (other liabilities)	168.9	(132.2)	172.6	(176.8)

31.5 Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2016 or at 31st December 2015.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

31. Derivatives and foreign exchange instruments (continued)

31.6 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 27.1 and credit risk is therefore, unlikely to dominate the change in fair value of such hedging instruments.

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 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:-

	2016	2015
	US$ millions	US$ millions
Net gains on derivatives fair value hedging instruments	47.5	0.7
Net losses on hedged items attributable to the hedged risk	(47.5)	(0.7)

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

31. Derivatives and foreign exchange instruments (continued)

31.6 Hedge accounting (continued)

The notional amount, fair values, and changes in fair values of hedging instruments for the year ended 31st December 2016 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 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

The carrying amount, accumulative changes in fair values, and changes in fair values of hedged instruments for the year ended 31st December 2016 used as the basis for recognising hedge ineffectiveness were as follows:-

	Carrying amount	Accumulative changes in fair value	Changes in fair value
	US$ millions	US$ millions	US$ millions
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 2016 or 31st December 2015.

Certain derivative cash flow hedging transactions were unwound during the year ended 31st December 2009. The resultant realised profits were recognised in the consolidated statement of income over the respective tenors of the original transactions for periods to the year ended 31st December 2015.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

32. 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:-

	Notional principal amount	**31.12.16 Risk-weighted exposure**	Notional principal amount	31.12.15 Risk-weighted exposure
	US$ millions	**US$ millions**	US$ millions	US$ millions
Direct credit substitutes	**627.1**	**619.3**	618.5	545.3
Transaction-related contingent items	**2,009.9**	**773.2**	1,950.1	767.4
Short-term self-liquidating trade-related contingent items	**442.8**	**79.4**	307.1	74.5
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**1,216.8**	**526.1**	1,586.7	602.1
	4,296.6	**1,998.0**	4,462.4	1,989.3

Commitments may be drawndown on demand.

Direct credit substitutes at 31st December 2016 included financial guarantees amounting to US$403.5 million (2015: US$508.2 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 2016, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US$316.0 million (2015: US$569.1 million).

33. 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.

34. 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 2016 and 31st December 2015.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

34. Capital adequacy (continued)

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

	31.12.16 US$ millions	31.12.15 US$ millions
Regulatory capital base		
Tier 1 capital:		
Total equity	**2,357.4**	2,431.0
Tier 1 adjustments	**-**	(13.0)
Tier 1 capital	**2,357.4**	2,418.0
Tier 2 capital:		
Stage 1 and stage 2 loan provisions (2015: non-specific provisions)	**165.5**	137.7
Tier 2 capital	**165.5**	137.7
Total regulatory capital base	**2,522.9**	2,555.7

	Notional principal amount US$ millions	Risk-weighted exposure US$ millions	Notional principal amount US$ millions	Risk-weighted exposure US$ millions
Risk-weighted exposure				
Credit risk				
Balance sheet items:				
Cash and other liquid assets	**3,095.0**	**82.9**	4,309.7	102.2
Securities purchased under agreements to resell	**635.0**	**3.8**	1,835.0	14.4
Placements	**4,715.3**	**985.3**	4,402.9	898.9
Investment securities	**4,066.4**	**1,265.8**	3,884.5	1,318.1
Loans and advances	**9,745.1**	**9,322.9**	9,161.4	8,797.8
Other assets, excluding derivative-related items	**388.2**	**497.3**	354.1	377.5
		12,158.0		11,508.9
Off-balance sheet items:				
Credit-related contingent items	**4,296.6**	**1,998.0**	4,462.3	1,989.3
Foreign exchange-related items	**9,230.3**	**82.2**	10,737.1	130.1
Interest rate-related items	**16,592.3**	**110.6**	14,333.9	8.3
Commodity contracts	**98.6**	**-**	52.2	-
Repo counterparty risk	**-**	**21.6**	-	30.2
		2,212.4		2,157.9
Credit risk-weighted exposure		**14,370.4**		13,666.8
Market risk				
General market risk		**27.1**		85.9
Specific market risk		**43.8**		53.9
Market risk-weighted exposure		**70.9**		139.8
Operational risk				
Operational risk-weighted exposure		**578.5**		570.3
Total risk-weighted exposure		**15,019.8**		14,376.9
Tier 1 risk asset ratio		**15.7%**		16.8%
Total risk asset ratio		**16.8%**		17.8%

Notes to the consolidated financial statements (continued)
For the year ended 31st December 2016

34. 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 (2015: 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.

35. 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 2016 was US$13,030.4 million (2015: US$12,406.5 million).

The Group acts as fund manager to an investment fund called the Emerging Market Opportunities Fund. In its capacity as fund manager, the Group is entitled to performance and management fees. The Group maintains an investment with the fund.

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 this case, and therefore has not consolidated the fund.

The maximum exposure to loss is equal to the carrying amount of the trading securities, which at 31st December 2016 amounted to US$48.5 million (2015: US$46.4 million).

36. 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 2016 or 31st December 2015, other than the senior term loan referred to in note 16.

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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

36. Related party transactions (continued)

The compensation of key management personnel was as follows:-

	2016	2015
	US$ millions	US$ millions
Short-term employee benefits	**9.2**	8.1
Post-employment benefits	**0.8**	0.5
	10.0	8.6

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.

37. 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.

37.1 Trading securities

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

37.2 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.

37.3 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.

37.4 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 2016 approximate the carrying values.

37.5 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.

37.6 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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

37. Fair value of financial instruments (continued)

37.7 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 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**	**-**
At 31st December 2015			
Financial assets:			
Trading securities	57.8	1.3	13.1
Investment securities - equities	172.4	-	99.5
Derivative financial instruments	-	172.6	-
Financial liabilities:			
Derivative financial instruments	-	176.8	-

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.

During the year ended 31st December 2016, the value of investment securities whose measurement was determined by other valuation techniques (level 3 measurement) decreased by US$23.7 million (2015: decrease of US$24.6 million). The decrease principally comprised changes in assigned valuations as recognised in other comprehensive income.

The increase in the value of trading securities whose measurement was determined by other valuation techniques (level 3 measurement) was principally related to the transfer of a trading security from level 1 to level 3 due to the unavailability of reliable price.

No transfers out of the level 3 measurement classification occurred during the years ended 31st December 2016 and 31st December 2015. Similarly, no transfers between level 1 and level 2 measurement classifications were made during the years ended 31st December 2016 and 31st December 2015.

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.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2016

38. 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.

	2016	2015
Net income (US$ millions)	37.3	90.4
Weighted average number of shares in issue (millions)	2,500	2,500
Basic earnings per share (US$)	**0.01**	0.04

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

39. 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 L.L.C.	Investment banking	Kingdom of Saudi Arabia

The Group's ownership interest in the principal subsidiary companies was 100 per cent for the years ended 31st December 2016 and 31st December 2015.

40. Average consolidated statement of financial position

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

	31.12.16 US$ millions	31.12.15 US$ millions
ASSETS		
Cash and other liquid assets	3,300.6	3,366.1
Securities purchased under agreements to resell	937.8	1,631.9
Placements	4,594.0	4,766.6
Trading securities	79.5	70.7
Investment securities	4,034.6	4,105.5
Loans and advances	9,613.6	8,798.8
Other assets	497.0	486.4
Total assets	**23,057.1**	23,226.0
LIABILITIES		
Deposits from banks	2,642.7	1,616.3
Deposits from customers	13,406.4	14,522.5
Securities sold under agreements to repurchase	1,490.4	1,345.8
Other liabilities	461.5	399.3
Senior term financing	2,620.9	2,645.0
Subordinated term financing	79.2	286.6
Total liabilities	**20,701.1**	20,815.5
Total equity	**2,356.0**	2,410.5
Total liabilities & equity	**23,057.1**	23,226.0

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 (the Group) 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 2016 amounted to US$15,019.8 million. Credit risk accounted for 95.7 per cent, market risk 0.5 per cent and operational risk 3.8 per cent of the total risk-weighted assets. Tier 1 and total regulatory capital were US$2,357.4 million and US$2,522.9 million respectively.

At 31st December 2016, GIB's tier 1 and total capital adequacy ratios were 15.7 per cent and 16.8 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 2016 unless otherwise stated.

Risk management and capital adequacy report (continued)
31st December 2016

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 2016, 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 currently 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 2016

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 2016

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 LLC	Saudi Arabia	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 Chief Executive Officer (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 Chief Risk Officer (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 Chief Financial Officer (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 2016

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 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 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: CEO)	Group Risk Committee (Chairman: CRO)	Assets and Liabilities Committee (Chairman: CFO)

The risk, liquidity and capital management responsibilities are set out in the table below:-

Chief Executive Officer	
Chief Financial Officer (CFO)	Chief Risk Officer (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 2016

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 Chief Risk Officer (CRO), Chief Credit Officer (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 2016

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 1997 Asian crisis, 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 2016

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 2016

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.

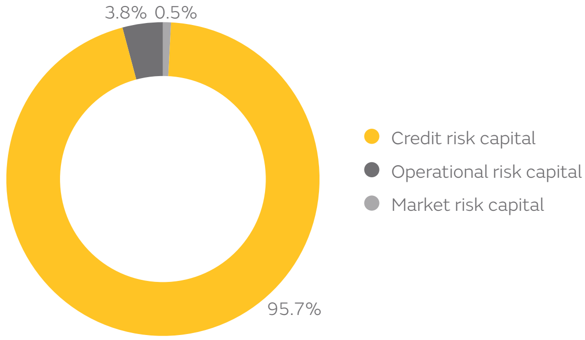
Risk reporting is regularly made to senior management and the Board of Directors. The Board of Directors receives internal risk reports covering market, credit, operational and liquidity risks.

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 2016

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	6,171.4	3.9	6,175.3	1%	31.1	3.9
PSEs	290.6	-	290.6	7%	20.1	2.5
Banks	5,843.3	152.6	5,995.9	31%	1,879.9	235.0
Corporates	1,267.2	11,160.5	12,427.7	94%	11,653.9	1,456.7
Equities	-	282.2	282.2	118%	333.6	41.7
Past due loans	-	83.2	83.2	114%	94.5	11.8
Other assets	14.7	371.1	385.8	93%	357.3	44.6
	13,587.2	**12,053.5**	**25,640.7**	**56%**	**14,370.4**	**1,796.2**

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 unrated exposure to banks comprises unrated subordinated loans to rated banks.

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	7.5	0.9
Equities	0.5	0.1
Foreign exchange risk	19.1	2.4
Total general market risk	27.1	3.4
Total specific market risk	43.8	5.5
	70.9	**8.9**

The general market risk calculation includes the addition of stressed VaR in accordance with CBB guidelines.

Risk management and capital adequacy report (continued)
31st December 2016

3. Regulatory capital requirements and the capital base (continued)

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 2016 amounted to US$72.3 million.

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	222.0	-	222.0
Voluntary reserve	159.5	-	159.5
Retained earnings	(507.3)	-	(507.3)
Unrealised losses from fair valuing equity investments	(24.4)	-	(24.4)
Collective impairment provisions	-	165.5	165.5
Tier 1 and tier 2 capital base	**2,357.4**	**165.5**	**2,522.9**

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 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 2016

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 1250 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 2016

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 Bank's 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 US$ millions	Average gross credit exposure US$ millions
Balance sheet items:		
Cash and other liquid assets (including cash balances)	3,095.0	3,300.6
Securities purchased under agreements to resell	635.0	937.8
Placements	4,715.3	4,594.0
Trading securities	91.9	79.5
Investment securities	4,066.4	4,034.6
Loans and advances	9,745.1	9,613.6
Accrued interest and fees receivable	167.1	142.5
Total on-balance sheet credit exposure	**22,515.8**	**22,702.6**
Off-balance sheet items:		
Credit-related contingent items	4,296.6	4,227.3
Derivative and foreign exchange instruments	223.6	112.9
Total off-balance sheet credit exposure	**4,520.2**	**4,340.2**
Total gross credit exposure	**27,036.0**	**27,042.8**

The average gross credit exposure is based on daily averages during the year ended 31st December 2016.

Risk management and capital adequacy report (continued)

31st December 2016

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	2,766.8	2,177.8	9,529.3	97.2	3,863.0	18,434.1
MENA (excluding GCC)	0.1	-	15.2	0.3	12.1	27.7
Europe	5,100.5	889.9	128.2	47.2	330.3	6,496.1
North America	397.4	608.4	30.8	17.5	266.3	1,320.4
Asia	180.5	469.6	41.6	4.9	48.5	745.1
Latin America	-	12.6	-	-	-	12.6
	8,445.3	**4,158.3**	**9,745.1**	**167.1**	**4,520.2**	**27,036.0**

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	4,229.4	1,089.4	1,924.9	84.8	570.0	7,898.5
Government	4,215.9	1,751.9	111.5	14.3	40.3	6,133.9
Energy, oil and petrochemical	-	425.9	1,975.0	13.5	945.1	3,359.5
Trading and services	-	6.9	2,086.3	9.7	398.4	2,501.3
Construction	-	10.6	615.3	2.0	1,654.2	2,282.1
Manufacturing	-	239.1	1,029.8	9.2	407.0	1,685.1
Transportation	-	151.6	1,256.8	6.7	175.2	1,590.3
Equity investments	-	343.0	-	11.3	3.1	357.4
Agriculture and mining	-	-	220.1	1.6	113.7	335.4
Real estate	-	62.4	185.5	4.9	30.0	282.8
Communication	-	46.4	159.8	1.0	12.9	220.1
Other	-	31.1	180.1	8.1	170.3	389.6
	8,445.3	**4,158.3**	**9,745.1**	**167.1**	**4,520.2**	**27,036.0**

Risk management and capital adequacy report (continued)

31st December 2016

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-	8,352.5	3,603.0	5,504.8	125.8	2,480.4	20,066.5
Rating grades 5+ to 5-	92.8	212.3	3,279.5	24.2	1,817.7	5,426.5
Rating grades 6+ to 6-	-	-	194.8	0.7	20.4	215.9
Rating grade 7	-	-	6.8	-	25.5	32.3
Equity investments	-	343.0	-	11.3	3.1	357.4
Carrying amount (net)	8,445.3	4,158.3	8,985.9	162.0	4,347.1	26,098.6
Stage 2						
Rating grades 5+ to 5-	-	-	371.3	4.6	-	375.9
Rating grades 6+ to 6-	-	-	226.3	0.5	122.5	349.3
Carrying amount (net)	-	-	597.6	5.1	122.5	725.2
Stage 3						
Rating grade 7	-	-	10.7	-	-	10.7
Rating grade 8	-	-	114.9	-	44.2	159.1
Rating grade 9	-	-	1.6	-	3.2	4.8
Rating grade 10	-	-	34.4	-	3.2	37.6
Carrying amount (net)	-	-	161.6	-	50.6	212.2
	8,445.3	**4,158.3**	**9,745.1**	**167.1**	**4,520.2**	**27,036.0**

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

Stage 1	-	(4.5)	(82.5)	-	-	(87.0)
Stage 2	-	-	(83.0)	-	-	(83.0)
Stage 3	-	-	(255.5)	-	-	(255.5)
	-	**(4.5)**	**(421.0)**	**-**	**-**	**(425.5)**

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 2016

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	7,178.3	310.4	3,437.8	121.1	11,047.6
4 months to 1 year	1,202.3	483.8	1,895.7	46.0	3,627.8
Years 2 to 5	50.0	2,142.3	3,489.5	-	5,681.8
Years 6 to 10	-	915.1	575.7	-	1,490.8
Years 11 to 20	-	-	113.5	-	113.5
Over 20 years and other	14.7	306.7	232.9	-	554.3
	8,445.3	**4,158.3**	**9,745.1**	**167.1**	**22,515.8**

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 2016, equity investment securities held in the banking book amounted to US$251.1 million, of which US$167.3 million comprised listed equities received in settlement of a secured past due loan and US$15.7 million comprised managed funds.

During the year ended 31st December 2016, US$2.8 million of gains were realised on equity investments. At 31st December 2016, net unrealised losses on equity investment securities amounted to US$24.4 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 2016

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	88.5	-	88.5
Banks	2,338.5	1,943.7	299.6
Corporates	457.0	154.2	-

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 2016

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	361.0	254.6	106.4
Financial institutions	6.2	0.9	5.3
	367.2	**255.5**	**111.7**

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				**361.0**
Transition adjustment on adoption of IFRS 9				**68.7**
At 1st January - restated	226.5	76.2	127.0	**429.7**
Transfer to stage 1	(10.7)	11.1	(0.4)	**-**
Transfer to stage 2	-	(4.2)	4.2	**-**
Transfer to stage 3	47.7	(0.2)	(47.5)	**-**
Amounts utilised	(46.0)	-	-	**(46.0)**
Exchange rate movements	(1.3)	-	-	**(1.3)**
Net remeasurement of loss allowance	39.3	(0.4)	(0.3)	**38.6**
At 31st December 2016	**255.5**	**82.5**	**83.0**	**421.0**

Following the adoption of IFRS 9 on 1st January 2016, the increase in provisions required under IFRS 9 were taken directly to retained earnings as a transition adjustment.

Amounts utilised during the year ended 31st December 2016 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 2016.

Risk management and capital adequacy report (continued)

31st December 2016

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	-	3.2	-	3.2
Transition adjustment on adoption of IFRS 9	-	-	-	-
At 1st January - restated	-	3.2	-	3.2
Net remeasurement of loss allowance	-	1.3	-	1.3
At 31st December 2016	**-**	**4.5**	**-**	**4.5**

At 31st December 2016, 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	328.6	84.2
Financial Institutions	10.7	9.8
	339.3	**94.0**

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	175.8	27.9	124.9	328.6
Financial Institutions	-	-	10.7	10.7
	175.8	**27.9**	**135.6**	**339.3**

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 2016

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, 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:-

	31.12.16	Average	High	Low
	US$ millions	US$ millions	US$ millions	US$ millions
Total VaR	0.4	0.2	0.5	-
Total undiversified stressed VaR	0.6	0.3	0.9	0.1

Risk management and capital adequacy report (continued)

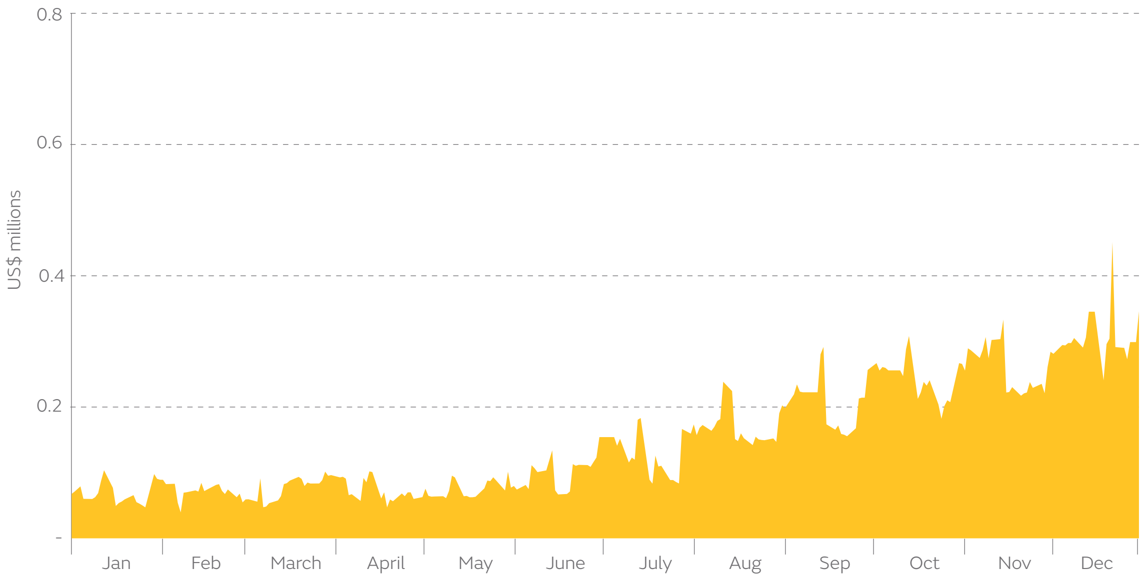
31st December 2016

5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)

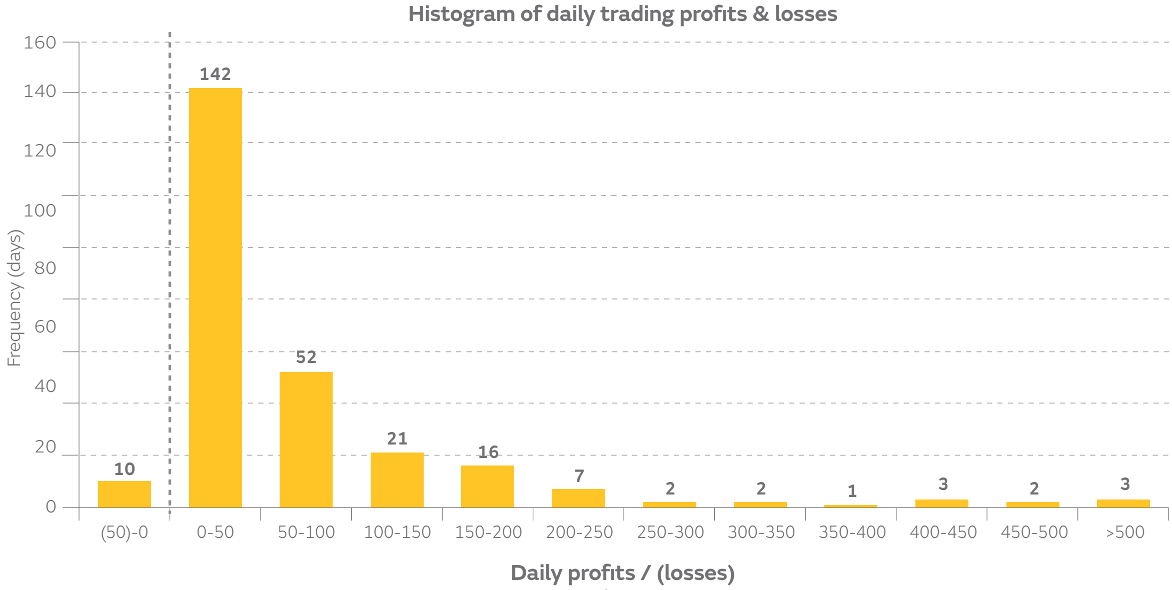
The graph below sets out the total VaR for all the Group's trading activities at the close of each business day throughout the period ended 31st December 2016:-

Trading Value-at-Risk daily development



The daily trading profits and losses during the year ended 31st December 2016 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 2016, 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 2016

5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)
The five largest daily trading losses during the year ended 31st December 2016 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
30th December	26	74
15th June	16	29
18th January	9	23
12th August	7	47
12th January	7	13

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 2016

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 factor is 50 per cent or 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	627.1	619.3	77.4
Transaction-related contingent items	2,009.9	773.2	96.6
Short-term self-liquidating trade-related contingent items	442.8	79.4	9.9
Commitments	1,216.8	526.1	65.8
	4,296.6	**1,998.0**	**249.7**

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 2016, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US$316.0 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 2016

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 2016 were as follows:-

	Trading US$ millions	Hedging US$ millions	Total US$ millions
Foreign exchange contracts:-			
Unmatured spot, forward and futures contracts	5,549.7	-	5,549.7
Options purchased	1,840.3	-	1,840.3
Options written	1,840.3	-	1,840.3
	9,230.3	-	9,230.3
Interest rate contracts:-			
Interest rate swaps	2,814.1	12,104.2	14,918.3
Cross currency swaps	1,159.6	-	1,159.6
Options, caps and floors purchased	257.2	-	257.2
Options, caps and floors written	257.2	-	257.2
	4,488.1	12,104.2	16,592.3
Commodity contracts:-			
Options and swaps purchased	49.3	-	49.3
Options and swaps written	49.3	-	49.3
	98.6	-	98.6
	13,817.0	**12,104.2**	**25,921.2**

7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the interest rate, foreign exchange, 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 2016

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	135.1	101.9	237.0	64.9	84.9	10.6
Corporates	74.7	72.3	147.0	49.2	108.0	13.5
Governments	13.8	-	13.8	-	-	-
	223.6	**174.2**	**397.8**	**114.1**	**192.9**	**24.1**

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	223.6	(82.4)	141.2

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 2016, 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 40 individual investments.

At 31st December 2016 the underlying investments in the CDOs for which the Group acted as collateral manager amounted to US$0.5 billion. At 31st December 2016, GIB did not hold any exposure to CDOs managed by the Group.

Risk management and capital adequacy report (continued)
31st December 2016

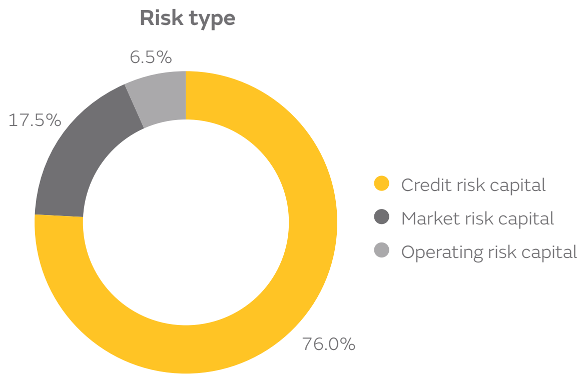
8. Internal capital including other risk types
GIB manages and measures other risk types that are not included under Pillar 1 in the CBB's Basel 3 framework. These are principally covered in the Group's internal economic capital model.

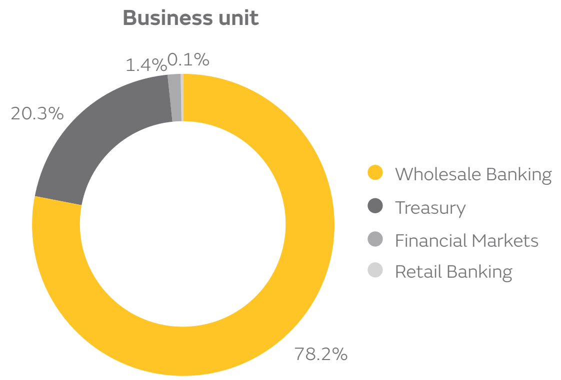
This section describes GIB's economic capital model and discusses the treatment of the other risk types that are not addressed in Pillar 1 of the CBB's Basel 3 framework.

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 2016

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$2,761.6 million at 31st December 2016. 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 2016, 64.7 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$10,387.7 million or 64.9 per cent of the Group's deposits at 31st December 2016 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 2016, 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 2016

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 2016, the following single obligor exposure exceeded 15 per cent of the Group's regulatory capital base (i.e. exceeding US$378.4 million).

	On-balance sheet exposure	Off-balance sheet exposure	Total exposure
	US$ millions	US$ millions	US$ millions
Counterparty A	444.7	-	444.7
Counterparty B	143.6	290.0	433.6

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	3,080.3	-	-	-	14.7	3,095.0
Securities purchased under agreements to resell	535.0	-	100.0	-	-	635.0
Placements	3,612.9	784.3	318.1	-	-	4,715.3
Trading securities	-	13.1	-	-	78.8	91.9
Investment securities:						
- Fixed rate	173.1	50.1	219.9	975.0	-	1,418.1
- Floating rate	1,364.9	1,036.8	-	-	(4.5)	2,397.2
- Equities	-	-	-	-	251.1	251.1
Loans and advances	8,132.9	1,736.6	41.1	-	(165.5)	9,745.1
Other assets	-	-	-	-	557.1	557.1
Total assets	**16,899.1**	**3,620.9**	**679.1**	**975.0**	**731.7**	**22,905.8**
Deposits	12,540.8	2,099.1	1,358.0	3.8	-	16,001.7
Securities sold under agreements to repurchase	983.4	338.1	-	-	-	1,321.5
Other liabilities	-	-	-	-	463.6	463.6
Term financing	2,761.6	-	-	-	-	2,761.6
Equity	-	-	-	-	2,357.4	2,357.4
Total liabilities & equity	**16,285.8**	**2,437.2**	**1,358.0**	**3.8**	**2,821.0**	**22,905.8**
Interest rate sensitivity gap	**613.3**	**1,183.7**	**(678.9)**	**971.2**	**(2,089.3)**	**-**
Cumulative interest rate sensitivity gap	**613.3**	**1,797.0**	**1,118.1**	**2,089.3**	**-**	**-**

Risk management and capital adequacy report (continued)

31st December 2016

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$975.0 million or 4.3 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 2016, the modified duration of these fixed rate government securities was 2.14. 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$209,000.

Based on the repricing profile at 31st December 2016, 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 of approximately US$6.5 million and an increase in the Group's equity of approximately US$6.6 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.

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)	931.4	15,019.8
Capital base (US$ millions)	286.6	2,522.9
Tier 1 capital (US$ millions)	286.6	2,357.4
Tier 1 ratio (per cent)	**30.8**	**15.7**
Total ratio (per cent)	**30.8**	**16.8**

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 2016

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 2016. 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 2016

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
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CCO	Chief Credit Officer
CRO	Chief Risk Officer
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
The Group	Gulf International Bank B.S.C. and subsidiaries
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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