GULF INTERNATIONAL BANK

2006 ANNUAL REPORT

THE GULF'S OWN MERCHANT BANK

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GULF INTERNATIONAL BANK

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

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

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

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

GIB
بنك الخليج الدولي

THE GULF'S OWN MERCHANT BANK

FINANCIAL HIGHLIGHTS

	2006	2005	2004	2003	2002
Earnings (US$ millions)					
Net Income after Tax	**255.5**	203.0	150.2	106.1	85.3
Net Interest Income	**257.7**	209.0	175.2	167.3	195.4
Non-Interest Income	**147.7**	139.2	121.4	120.3	88.7
Operating Expenses	**144.0**	138.7	124.4	126.1	115.6
Financial Position (US$ millions)					
Total Assets	**24,787.2**	22,856.6	19,239.0	17,454.6	16,388.7
Available-for-Sale Securities	**8,422.9**	7,839.6	8,469.1	8,451.8	8,280.4
Loans	**8,145.0**	6,273.7	4,847.1	3,710.5	3,408.0
Senior Term Financing	**1,867.1**	1,944.5	1,678.3	1,501.3	880.0
Equity	**1,856.6**	1,718.3	1,586.6	1,440.7	1,180.1
Ratios (Per cent)					
Profitability					
Return on Average Equity	**14.3**	12.3	9.9	8.1	7.0
Return on Average Assets	**1.1**	1.0	0.8	0.6	0.5
Capital					
BIS Risk Asset Ratio					
- Total	**11.6**	12.7	11.0	12.0	12.8
- Tier 1	**8.7**	9.2	9.7	10.4	10.3
Equity as % of Total Assets	**7.5**	7.5	8.2	8.3	7.2
Asset Quality					
Securities as % of Total Assets	**42.8**	43.1	52.4	57.5	57.9
Loans as % of Total Assets	**32.9**	27.4	25.2	21.3	20.8
Liquidity					
Liquid Assets Ratio	**65.2**	70.9	73.9	77.9	77.2
Deposits to Loans Cover (times)*	**2.3**	2.5	2.6	3.2	3.4

* Deposits include Senior Term Financing

Credit Ratings

	Fitch	Moody's	Standard & Poor's	Capital Intelligence
Long-term	A	A3	A-	A
Short-term	F1	P-2	A-2	A2
Individual	C			
Financial Strength		C-		A-
Outlook	Stable	Stable	Stable	Stable

GIB's long-term foreign currency rating was upgraded by Fitch Ratings from 'A-' to 'A', while the current ratings of 'A' by Capital Intelligence, 'A-' by Standard & Poor's and 'A3' by Moody's were re-affirmed during the year.

BOARD OF DIRECTORS

H.E. SHEIKH EBRAHIM BIN KHALIFA AL KHALIFA
Chairman
Undersecretary, Ministry of Finance
Kingdom of Bahrain

MR. ABDUL AZIZ M. AL-ABDULKADER
Vice Chairman
President, AMA Group
Kingdom of Saudi Arabia

MR. BADER ABDULLAH AL-RUSHAID AL-BADER
Ex-Chairman and Managing Director
Kuwait Investment Company
State of Kuwait

DR. HAMAD BIN SULAIMAN AL-BAZAI
Deputy Minister for Economic Affairs
Ministry of Finance
Kingdom of Saudi Arabia

MR. SAUD BIN NASSIR AL-SHUKAILY
Secretary General for Taxation
Ministry of Finance
Sultanate of Oman

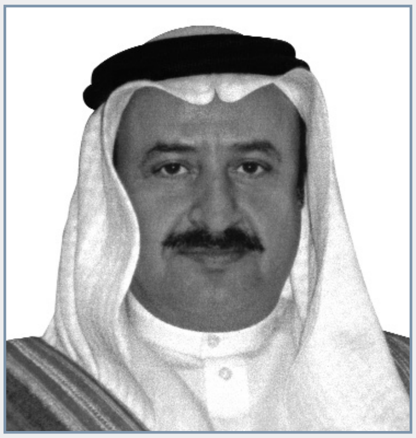
DR. KHALID BIN ABDULLA AL-SWEILEM
Director General, Investment Department
Saudi Arabian Monetary Agency
Kingdom of Saudi Arabia

MR. KHALID BIN ABDULLA AL-SUWAIDI
Head of Administration
Qatar Investment Authority
State of Qatar

MR. NASSER KHAMIS AL-SUWAIDI
Director of the Minister's Office
Ministry of Finance and Industry
The United Arab Emirates

DR. ABDUL RAHMAN BIN AHMED AL-JAFARY
Ex-Secretary General
Gulf Organisation for Industrial Consulting
Kingdom of Saudi Arabia

CHAIRMAN'S STATEMENT



Sheikh Ebrahim Bin Khalifa Al Khalifa
Chairman

ON BEHALF OF THE BOARD OF DIRECTORS, it is my privilege to present the annual report of Gulf International Bank (GIB) for the year ended 31st December 2006.

I am delighted to report that 2006 proved to be the most successful year in the Bank's history. Record financial results and sound strategic progress were supported by significant business achievements and organisational developments.

With enhanced performance across all major business activities, the Bank posted a record consolidated net income for the third consecutive year, continuing the upward trend in GIB's financial performance since 2002. Net income after tax for 2006 was US$255.5 million, up 26 per cent over the previous record of US$203.0 million for 2005.

This strong result reflects increases in both interest and non-interest earnings and a lower level of provisions for credit losses. Net interest income at US$257.7 million was US$48.7 million or 23 per cent up on the previous year, while non-interest earnings increased by US$8.5 million or 6 per cent.

Increases were recorded in all non-interest income categories, with the exception of profits on available-for-sale securities, and fee-based income rose by 42 per cent to US$65.8 million. The increase in fee and commission income, which now represents the Bank's largest non-interest income category, was partly attributable to a strong growth in corporate advisory and asset management fees, with client assets under management increasing to a record level of US$21.7 billion during the year.

The overall year-on-year advance is all the more impressive when viewed in relation to GIB's very conservative risk profile, and the increasingly competitive nature of the regional and international markets in which the Bank operates. This clearly illustrates the soundness of the Bank's merchant banking strategy focused primarily on the Gulf Cooperation Council (GCC) states, which has successfully contributed to a diversification of earnings and sustained growth and profitability. In 2006, GIB continued to provide shareholders with enhanced returns, while maintaining favourable recognition from clients, counterparties, supervisory authorities, international credit rating agencies and market monitors.

Economic prospects for the GCC region remain robust, buoyed by higher oil production and prices, expansionary fiscal policies, favourable interest rates, and a growing tendency toward inward investment opportunities. These factors resulted in substantially enhanced liquidity levels, and enabled the region to accumulate fiscal and current account surpluses. As a result, public spending in major infrastructure and industrial projects was further increased, with regional governments and public sector entities increasingly tapping financial markets for their funding requirements, including the use of Islamic instruments. The private sector continued to enhance its contribution to the ongoing economic expansion, including investments, both domestic and foreign, in real estate and infrastructure development, tourism and industry.

GIB's business activities benefited from this strong growth momentum in the region. The Merchant Banking group achieved, for the second consecutive year, its highest performance across all divisions within the group. During 2006, the Bank participated in a record number of major projects and transactions, and also acted as sole leader and underwriter in a greater number of deals. As well as maintaining its status as the primary provider of project and structured finance services in the MENA region, GIB consolidated its position as the leading financier and arranger specialising in oil, gas, petrochemical, power generation, and manufacturing sector projects. At the same time, the Bank continued to expand its activities in other areas – in particular shipping finance, secondary market loan asset trading, Islamic finance, and GCC private equity – as well as remaining the region's most active financial institution in the loan agency business.

An important achievement during the year was the upgrade in GIB's long-term foreign currency rating from "A-" to "A" by Fitch Ratings, together with the reaffirmation of GIB's current ratings of "A3" by Moody's, "A-" by Standard & Poor's and "A" by Capital Intelligence. In addition, Fitch Ratings upgraded GIB's US$350 million floating rate note from "A-" to "A" and its US$400 million subordinated debt from "BBB" to "A-." These upgrades continue to reinforce the Bank's status as one of the highest-rated financial institutions in the Middle East.

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

Ebrahim Bin Khalifa Al Khalifa

Chairman

In addition to maintaining its position as the region's primary provider of project financing and the most active conventional loan agency, the Bank is now the leading Islamic facility agent in the region, and a major underwriter and arranger of term finance for financial institutions.

THE SUSTAINED EXPANSION OF THE GLOBAL ECONOMY, coupled with a continued robust performance by GCC economies, provided added stimulus to GIB's business environment in 2006. As a result, a strong performance across all major areas of operation enabled the Bank to expand its business activities and achieve record financial results.

Prospects for 2007 continue to look encouraging. This is supported not only by the ongoing economic expansion and diversification in the GCC and regional markets, but also by GIB's more balanced earnings profile, upgraded international credit ratings, and success in identifying new business opportunities. In addition, demand for GIB's merchant and investment banking services is expected to increase due to continued reforms and liberalisation in the GCC financial markets.

ECONOMIC AND BUSINESS OVERVIEW

Global economic growth expanded at a healthy pace, averaging over 5 per cent in 2006, after moderating slightly the year before. Major stock markets around the world continued their strong trading momentum, with emerging markets again enjoying higher than average returns. On commodity exchanges, crude oil and precious and base metals witnessed strong demand driven by the buoyant global activity.

Regional economic conditions have remained robust, with the strong expansionary conditions boosting domestic confidence, and local economies enjoying greater prosperity, in spite of the volatility experienced across the regional stock markets early in the year. This is further evident in the expanding array of inward investment opportunities, underpinned by significant support from the local private sectors. A key underlying influence to these developments is the continued high level of oil prices, favourable interest rates and expansionary fiscal policies. This has fuelled regional liquidity levels, enabled the accumulation of substantial fiscal and current account surpluses, and enhanced the favourable risk profiles of the GCC countries.

Economic reform remained a key underlying policy theme of the regional governments during 2006. Improved transparency in fiscal policy and government finances, enhanced capital market regulation, increased foreign ownership and competition, and changes in labour laws, were just some of the positive developments benefiting the GCC economies.

The privatisation of key services, industries and infrastructure installations, as well as the re-organisation of other public concerns into corporations, has enabled governments to pass on to the regional financial markets the financing of the investment and working capital demands of many productive public units. In 2006, the region continued to witness significant private and joint sector expansion in base metals, petrochemicals, liquefied natural gas, power generation, water supplies, information technology, construction materials and logistics.

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

MERCHANT BANKING

Despite an increasingly competitive market, GIB's merchant banking business enjoyed an extremely successful year in 2006. In addition to maintaining its position as the region's primary provider of project financing and the most active conventional loan agency, the Bank is now the leading Islamic facility agent in the region, and a major underwriter and arranger of term finance for corporations and financial institutions. GIB participated in a record number of deals and transactions, and also acted as sole underwriter in the highest number of syndicated deals in the Bank's history.

These achievements were helped by the recent streamlining of operations and adoption of an integrated approach to providing financial advisory services for debt and equity in coordination with project and structured finance, Islamic banking, syndication and capital market teams, which have resulted in improved synergies and a more focused response to clients' needs. In addition, the successful consolidation of product and distribution functions into a single platform has further strengthened the Bank's client relationships and helped to develop additional cross-selling opportunities. Moreover, GIB is actively monitoring the developments of capital markets in the GCC. The Bank's Capital Markets unit acted in 2006 as joint lead manager and book runner in the US$270 million Sukuk issuance for Qatar Real Estate Investment Company and the US$100 million Sukuk issuance for National Industries Company for Building Materials in Kuwait.

The demand for Islamic financial structures and products across the region continues to grow. GIB is well placed to respond to this demand through its comprehensive Sharia-compliant offering that includes project financing, structured finance, syndicated lending, Sukuk issuance, corporate advisory, and corporate and institutional banking services. These are provided to a wide client base comprising major private sector corporations, multinational organisations, Gulf-based Islamic financial institutions, and governments of GCC states. In 2006, the Bank was involved in a record number of Islamic deals, including lead management, book running and investment in several high profile Islamic Sukuk issues.

GIB was also a significant underwriter and arranger of term finance for corporations and financial institutions in the region during 2006. Syndicated facilities were provided for Islamic institutions including Al Rajhi Bank, Kuwait Finance House, Shamil Bank, and Kuwait Turkish Participation Bank; and for conventional banks such as First Gulf Bank, Awal Bank, Commercial Facilities Company, and Turk Exim.

During 2006, the Bank played a leading role in the financing of numerous large-scale projects in a number of key sectors across the GCC. These include oil, gas and petrochemicals, transportation, power and water, telecommunications, and infrastructural development.

In the oil, gas and petrochemical sectors, GIB was a mandated lead arranger (MLA) for the majority of the projects in the Gulf region, including a 15-year limited recourse project financing facility for an integrated refinery and petrochemical complex at Rabigh, Saudi Arabia, the largest petrochemical project financing deal completed to date in the GCC. The Bank also acted as MLA for other projects in the Kingdom including a 13-year US$1.7 billion project financing facility for a greenfield petrochemical complex at Yanbu, one of the largest industrial projects to be sponsored by Saudi Basic Industries Company; a US$565 million facility for private-sector petrochemical complexes to be constructed in Jubail; and a US$527 million Ijara investment facility for a greenfield propylene and polypropylene plant at Jubail. In the UAE, GIB was

MLA for an 11-year US$500 million Ijara financing facility to part finance the upgrading of an oil refinery at Jebel Ali for ENOC, while in Oman, the Bank was the sole original MLA, sole underwriter, facility agent and security trustee for a US$234.5 million refinancing facility for Oman Gas.

In the transportation sector, GIB was MLA for a US$326 million syndicated loan facility for the Arab Maritime Petroleum Transport Company, Kuwait; a US$500 million term and revolving facility for Qatar Gas Transport Company (Nakilat); a US$1.72 billion senior debt facility and a US$177 million subordinated facility to finance the purchase of LNG ships by a subsidiary of Nakilat, and a US$145 million LNG ship financing facility for a subsidiary of Oman Shipping Co.

In the power and water sector, GIB acted as the coordinating MLA for a US$1.9 billion facility for the financing of an independent water and power project (IWPP) for Shuqaiq Water & Electricity Company of Saudi Arabia (closed in February 2007); a US$605 million facility for the Hidd Power Company, Bahrain; a 25-year US$486 million term loan facility for the Qatar Electricity & Water Company; and a US$350 million Sukuk Al Ijara facility for the Sharjah Electricity and Water Authority, UAE.

In the telecommunications sector, GIB was involved as MLA in three of the largest Islamic financing transactions during 2006: the US$1.9 billion one-year Murabaha bridge facility for Ethihad Etislat (Mobily) in Saudi Arabia, the US$1.2 billion Murabaha facility for Mobile Telecommunications Company of Kuwait, and the US$2 billion three-year syndicated revolving standby credit facility for Qatar Telecom. In the infrastructural development sector, the Bank was MLA for the US$300 million syndicated loan to finance the new City Centre being constructed by the Majid Al Futtaim Group in Bahrain.

GIB maintains a presence outside the GCC region through its branches in London and New York, and its representative office in Beirut. Based on significant trade flows and long-term relationships with the GCC, the Bank's international trade finance and institutional lending business is mainly conducted in the MENA region. In 2006, the Bank increased its support for the growing number of international contractors and sponsors involved in projects in the region through the issue of performance and project-related guarantees, and working capital facilities.

INVESTMENT BANKING

Regional capital markets have witnessed unprecedented growth and development in the last few years as surging oil prices have allowed for abundant liquidity, strong corporate performance, and positive business and consumer sentiment. Multiple deregulation and liberalisation themes, as well as the low global interest rate environment have furthered this process.

During 2006, regional stock markets experienced a major correction following a period of heady growth. However, financial stability has been preserved and the overall macroeconomic impact was limited. This resilience has been supported by the strong economic fundamentals across the Gulf countries and growing domestic demand for capital market products to diversify funding needs of the region's vast investment requirements over a broad asset class. Meanwhile, although conventional bond markets are still in the early stages of development, the market for Islamically structured bonds (i.e. Sharia-compliant Sukuks) is expanding rapidly. Investment in Sukuks has become an integral part of regional asset allocation and diversification.

GIB continued to grow its investment banking business in 2006, retaining its regional role as a pre-eminent adviser and arranger for private placements and IPOs. The Bank acted as exclusive financial adviser for the private sale of equity of US$425 million in AlBaraka Banking Group (ABG), and the subsequent IPO for US$582 million and concurrent listing on the Bahrain Stock Exchange and the Dubai International Financial Exchange. ABG was the first company to carry out a simultaneous listing on these exchanges, paving the way for future transactions.

GIB also acted as exclusive financial adviser for a number of IPOs on the Saudi Stock Exchange, including the US$177 million IPO for the 66.4 million shares in Advanced Polypropylene Company, and the US$119 million IPO for 7.2 million shares in Saudi Paper Manufacturing Company. In addition, GIB advised Dubai Investments PJSC in acquiring a 100 per cent stake in Saudi American Glass Company. The Bank also maintained its status as the regional leader in the provision of project advisory services, and is one of the few financial institutions in the GCC with a dedicated, professional advisory team.

In line with its investment banking strategy, GIB actively pursued private equity transactions during 2006. The Bank is also a co-sponsor of the GCC Energy Fund Limited – a first-of-its-kind private equity fund investing in regional energy and energy-related industries. The Fund successfully completed three investments during the year, including the acquisition of a 46 per cent shareholding in Dhofar Power Company in Oman by a consortium of investors, with the Fund holding a 13 per cent stake.

FINANCIAL MARKETS AND ASSET MANAGEMENT

Building on the previous year's record achievements, GIB's financial markets and asset management business enjoyed further significant growth in client assets and revenues during 2006. The international market environment was generally positive, although it suffered from a degree of volatility during the summer months, while Middle Eastern and other Emerging Market equity markets experienced significant corrections earlier in the year. The general level of global liquidity, particularly in the Middle East, continued to increase demand for innovative and sophisticated investment products.

Client assets under management by the Bank's UK-based investment banking subsidiary – GIBUK – grew to US$21.7 billion and have almost doubled in the past three years, reinforcing GIB's status as the largest manager of client assets in the Middle East. As a result, fees derived from the management of client portfolios and structured products continued to rise. Further growth is anticipated.

In 2006, GIB also continued to develop its structured products range, utilising its extensive experience gained from trading these securities on its own account and for the benefit of a growing client base in Europe, with institutional funds now worth more than US$2.0 billion. Following issues during the last four years of Euro and Sterling denominated CDOs, GIB built on its status within Europe as a leading manager of mezzanine ABS products. In 2006, GIB issued its fifth ABS CDO and its first to be denominated in US dollars. The US$400 million FAB US 2006-1 PLC is backed by a portfolio of senior, mezzanine and junior asset-backed and synthetic securities.

Financial markets trading also enjoyed a significant increase in profitability, due in part to the successful application of its asset allocation strategies. This has been successfully expanded to segregated client portfolios, where the mandate is predominantly based on discretionary asset allocation. In addition, the successful implementation of market neutral credit trading activities has contributed to highly profitable trading of niche credit markets, despite a net widening in credit spreads. In 2006, GIB built on its highly successful trading of Emerging Market bonds by entering into Emerging Market equity trading, with a long term strategy of creating related client products as a track record develops.

GIB's UK-based investment team manages a range of internationally oriented investment products and assets, operating through three market groups. Equity markets cover global and regional equities and convertibles; credit markets cover investment grade and high yield corporate debt and asset-backed securities; while government markets cover developed and emerging market bonds, interest rates and currencies.

TREASURY

In 2006, Treasury posted another record performance, and continued to make a substantial contribution to GIB's net income. Treasury is responsible for the Group's funding activities and capital market investment activities, and also manages the balance sheet. Over the years, it has successfully established GIB as a leading name in international and regional money markets, with a reputation as a reliable and professional business partner. It offers a wide range of treasury and capital market products and services to a diverse client base consisting of regional corporates, conventional and Islamic financial institutions and government entities; and also implements customised hedging strategies on behalf of the Bank's customers.

Treasury's significant portfolio of investment-grade-rated floating rate securities, which totals US$7.2 billion, continues to underpin the Bank's investment activities. This available-for-sale debt securities portfolio is highly liquid and generates a stable income stream, as well as providing considerable diversification of risk. In addition, Treasury makes selective investments in specialised markets and asset classes through external fund managers in line with the Bank's policy to seek an asset mix with adequate diversification. Those investments performed well in 2006, with some funds producing exceptionally strong returns. Owing to the prevailing market conditions during the year, Treasury experienced strong foreign exchange flows from customers, and increased demand for derivatives to hedge their interest and currency risks.

Another highlight of the Group's balance sheet development during the year was the significant increase in customer deposits, which has further enhanced the Bank's funding quality. GCC capital markets witnessed further successful bond issues in 2006, including conventional floating rate notes and the increasingly popular Islamic Sukuks. GIB participated in these issues, illustrating its strategic commitment to the region, and further reinforcing its dominant position in the Gulf's banking industry.

GIB acted in 2006 as exclusive financial adviser for a number of IPOs on the Saudi Stock Exchange, including the US$177 million IPO of Advanced Polypropylene Company, and the US$119 million IPO of Saudi Paper Manufacturing Company.

CONSOLIDATED NET INCOME WAS AT A HISTORIC RECORD LEVEL IN 2006. This was the third consecutive year in which the Bank has reported a record profit. Consolidated net income after tax at US$255.5 million for the year was US$52.5 million or 25.9 per cent up on the prior year. This represented a return on average equity of 14.3 per cent compared to a return of 12.3 per cent in 2005.

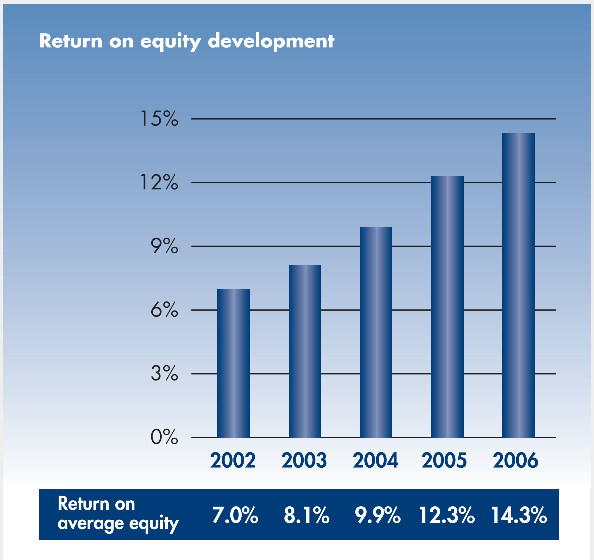
The strong performance reflected further improvements across all of the Bank's principal business activities, demonstrating the continued success of the Group's GCC-focused merchant banking strategy. The significant year-on-year increase in the Group's profit was attributable to increases in all income categories, with the exception of profits on available-for-sale securities, and a reduction in provisions for credit losses. Total income was US$61.8 million or 17.9 per cent up on the prior year. An increase in interest earnings was principally due to significantly higher loan volumes, related in particular to GCC project and structured financings, and a more favourable interest rate environment. GIB continues to be the leading financier and arranger of specialised lending within the GCC. Non-interest income benefited from strong fee-based income derived from the Group's strategically important merchant banking activities, including asset and fund management and corporate advisory. Operating expenses were up by a modest US$5.3 million on the prior year. As referred to in the section on operating expenses, GIB's profit per employee and cost to income ratios continue to be extremely efficient by international comparison. 2006 net income included a US$2.4 million net provision release. This compared to a US$2.2 million net provision charge in the prior year. The net provision release in 2006 was attributable to provision releases arising on the sale and settlement of impaired loans and securities at amounts exceeding their provisioned book values. It also reflects GIB's ongoing proactive and disciplined management of risk.

NET INTEREST INCOME

Net interest income at US257.7 million was US$48.7 million or 23.3 per cent up on the prior year. Net interest income is derived from the following principal sources:

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

The year-on-year increase in net interest income was partly attributable to higher net interest earnings derived from the Group's commercial lending portfolio. Loan margin income was 32 per cent up on the previous year. This reflected a significant growth in the loan portfolio during the year with a slight decrease in margins. In particular, the volume of GCC loans grew by US$1.9 billion or 35.2 per cent during 2006. While margins decreased slightly year-on-year, they nevertheless remained strong being attributable to a continued focus on higher value-added, skill-based commercial banking activities, including project and structured financings and lead manager roles in syndicated facilities.

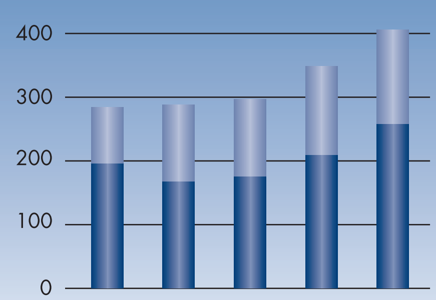


Margin income on the available-for-sale securities portfolio accounted for 22 per cent, or almost one quarter, of net interest income in 2006. Margin income on available-for-sale securities decreased by 5.9 per cent in 2006 with maturing assets being replaced at lower spreads following the significant narrowing in credit spreads that has taken place over the last three years. The credit quality of the available-for-sale securities portfolio continued to be emphasised with 97.4 per cent of available-for-sale debt securities at the 2006 year end being investment grade-rated.

Money book earnings represent the differential between the funding cost of interest-bearing assets based on internal transfer pricing methodologies and the actual funding cost incurred by the Bank. This includes benefits derived from the mismatch of the repricing profile of the Group's interest-bearing assets and liabilities. Money book earnings in 2006 were 65 per cent up on the prior year reflecting in particular the benefit derived from the higher levels of liquidity prevailing in the region and the associated higher level of deposits.

Short term US interest rates continued to rise during 2006. The Federal Reserve raised interest rates four times during the year from 4.25 per cent to 5.25 per cent at the end of 2006. The increases in interest rates contributed to an enhancement of the interest earnings on the investment of the Group's net free capital. The net free capital was partly uninvested during the year with the uninvested funds placed on a short term basis in the money market. This position had been adopted during 2005 in anticipation of a rising interest rate environment, and resulted in a higher overall yield on the net free capital funds in 2006.

Gross income development (US$ millions)



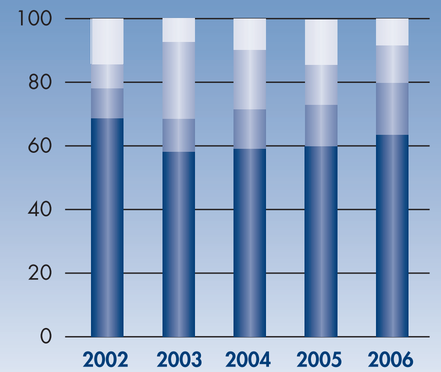
	2002	2003	2004	2005	2006
Non interest income	88.7	120.3	121.4	139.2	147.7
Net interest income	195.4	167.3	175.2	209.0	257.7
Gross income before provisions	**284.1**	**287.6**	**296.6**	**348.2**	**405.4**

NON-INTEREST INCOME

Non-interest income comprises fee and commission income, trading income, profits on available-for-sale securities, and other income. All non-interest income categories with the exception of profits on available-for-sale securities recorded increases over prior year levels.

Fee and commission income, which at US$65.8 million represented the second largest income category, was at a record level. Fee and commission income was US$19.6 million or 42.4 per cent up on 2005, which in itself was 25.9 per cent up on 2004. Fee and commission income has grown by 150 per cent in the four years since the GCC-focused merchant banking strategy was adopted in 2002. An analysis of fee and commission income with prior year comparatives is set out in note 19 to the consolidated financial statements. Investment banking and management fees at US$44.2 million were US$13.2 million or 42.6 per cent up on the prior year. This followed year-on-year increases of 26.3 per cent, 25.5 per cent and 10.6 per cent in 2005, 2004 and 2003 respectively. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory and underwriting activities. The significant year-on-year increases since 2002 reflect the Group's successful efforts in diversifying revenues though the development of a wide range of customer-related products and services. The increase in asset and fund management fees in 2006 was attributable to a higher volume of funds under

Gross income composition (%)



	2002	2003	2004	2005	2006
Other	14.4	7.3	9.8	14.2	8.3
Trading income	7.5	24.2	18.7	12.5	11.9
Fee and commission income	9.4	10.4	12.4	13.3	16.2
Net interest income	68.7	58.1	59.1	60.0	63.6
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

management. As referred to in note 31 to the consolidated financial statements, assets held in a fiduciary capacity increased by US$3.8 billion or 21 per cent during the year to US$21.7 billion at 31st December 2006. Commissions on letters of credit and guarantee at US$15.7 million were US$3.7 million or 30.8 per cent up on the prior year and therefore continued to make an important contribution to fee and commission income. The year-on-year advance was largely attributable to an increase in guarantee commissions on GCC-related business activities.

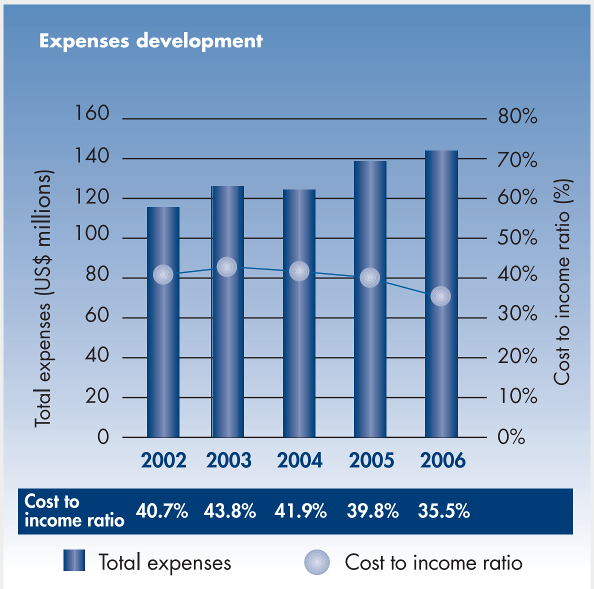
The Group's various trading activities, including foreign exchange, generated a US$48.2 million profit for the year compared to a US$43.6 million profit in 2005. Trading income is reported inclusive of all related income, including interest income, gains and losses arising on the purchase and sale, and from changes in the fair value of trading securities, dividend income, and interest expense, including all related funding costs. Strong trading revenues were generated in particular from corporate and emerging market debt trading and foreign exchange, although material contributions were also made by the Group's equity trading activity and by investments in externally managed funds. 2006 was characterised by strong performances across most credit-related asset classes, notably corporate and emerging market debt despite the tight spreads prevailing during the year. Trading revenues benefited from relative value, arbitrage and non-directional trading strategies. Foreign exchange revenues benefited from strong customer-related business. An analysis of trading income is set out in note 20 to the consolidated financial statements.

Profits on available-for-sale securities amounted to US$28.8 million for the year. The decrease compared to the previous year was largely due to the inclusion in 2005 income of a US$16.7 million profit arising as a result of the active management of the investment of the Group's net free capital in fixed rate securities. In 2006, profits of US$8.8 million were realised on the sale of shares and bonds received in previous years as part of impaired loan restructurings. Profits were also realised on the early redemption of securities in the floating rate debt security portfolio, which is commented on in more detail in the section on available-for-sale securities, and on private equity-related investments.

Other income of US$4.9 million principally comprised dividends received from available-for-sale equity investments, and recoveries on loans written off in previous years.

OPERATING EXPENSES

Operating expenses at US$144.0 million were a modest US$5.3 million up on the prior year. As explained in more detail later in this section, the year-on-year increase was recorded almost entirely in other operating expenses. Despite the year-on-year increase in expenses, GIB continues to maintain one of the highest profit per employee ratios for any bank in the world in addition to an extremely low cost to income ratio. According to a survey of the top 1,000 banks in the world published by The



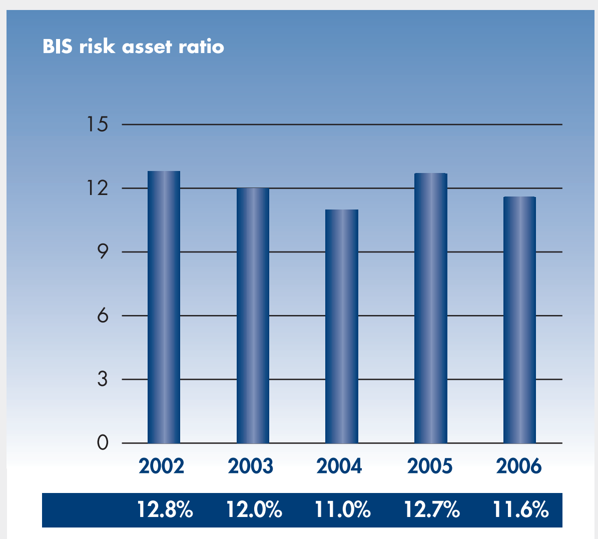
Banker magazine in July 2006, GIB's profit per employee in 2005 was one of the highest among the top 1,000 banks ranked by Tier 1 capital. The pre-tax profit per employee in 2006 was US$445,000. In addition, the cost to income ratio of 39.8 per cent in 2005 was significantly lower than the average ratio for each geographic region, including the USA (58.2 per cent), Europe (60.1 per cent) and Japan (71.4 per cent). In 2006, the Group's cost to income ratio decreased further to 35.5 per cent, an extremely efficient ratio by international comparison.

Staff expenses were only US$0.2 million up on the prior year. In 2005, staff expenses included one off release expenses, partly associated with a restructuring of the New York branch in order to derive further efficiencies from the relocation of back office functions to Head Office. These exceptional costs were offset in 2006 by higher performance-related remuneration as a result of the Group's significantly stronger performance. Other operating expenses were US$4.5 million up on the prior year. This was principally attributable to higher IT-related costs associated with ongoing IT infrastructure projects undertaken to achieve greater operating efficiencies. IT-related costs represent one third of total other operating expenses.

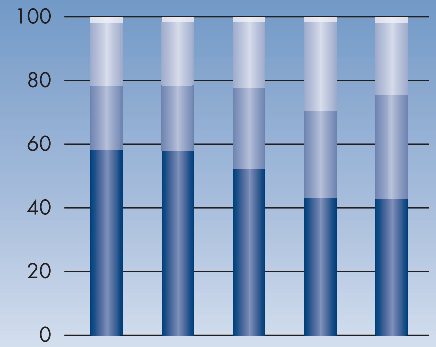
CAPITAL STRENGTH

Total equity amounted to US$1,856.6 million at 31st December 2006. At the 2006 year end the ratio of equity and Tier 1 capital to total assets were 7.5 per cent and 7.1 per cent respectively, ratios that are high by international comparison. The average Tier 1 capital to total assets ratio of the top 1,000 world banks was 4.45 per cent according to a survey published in The Banker magazine in July 2006.

A US$138.3 million increase in total equity during 2006 comprised the net of the US$255.5 million profit for the year, a US$101.5 million dividend paid in respect of 2005, and a US$15.7 million net decrease in the fair value of available-for-sale securities and derivative cash flow hedges. In accordance with IAS 39, changes in the fair values of available-for-sale securities and derivative cash flow hedges are accounted for in equity. The net decrease in the fair value of available-for-sale securities and derivative cash flow hedges was largely attributable to unrealised gains at 1st January 2006 of US$14.4 million that were accounted for in net income during 2006 in the form of realised profits. The realised profits largely arose on the early redemption of the related securities.



Asset mix by category (%)



	2002	2003	2004	2005	2006
Other	2.0	1.6	1.5	1.6	1.9
Placements, due from brokers, and other liquid assets	19.5	19.9	20.9	27.9	22.4
Loans and advances	20.1	20.5	25.2	27.4	32.9
Securities	58.4	58.0	52.4	43.1	42.8
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

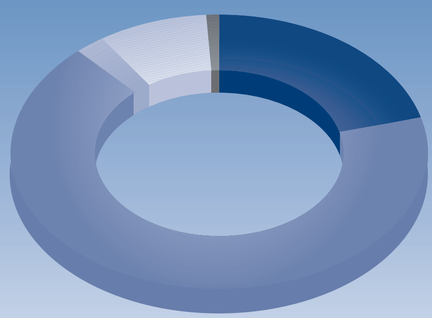
With a total regulatory capital base of US$2,376.6 million and total risk-weighted exposure of US$20,418.5 million, the risk asset ratio calculated in accordance with the guidelines of the Basel Committee on Banking Supervision was 11.6 per cent. In accordance with international regulatory guidelines, the fair value adjustments to equity arising under IAS 39 in relation to available-for-sale securities and derivative cash flow hedges are excluded from the regulatory capital base, with the exception of unrealised gains and losses on equity investments. As a result, at the 2006 year end net fair value gains of US$90.0 million were deducted from equity to derive the regulatory capital base for capital adequacy purposes. The Bank's regulatory capital base is enhanced by subordinated term financing facilities amounting in total to US$550.0 million. The Tier 2 capital base was enhanced during the year by two new 10 year subordinated loans, amounting in total to US$150 million, that replaced two existing subordinated loans that were called during 2006 on their fifth anniversary. The subordinated term financing facilities are approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Central Bank of Bahrain (CBB). The risk asset ratio incorporates market risk-weighted exposure. Exposure to general market risk is calculated utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risk. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the CBB. Note 30 to the consolidated financial statements provides further details on capital adequacy. The risk asset ratio calculated in accordance with the guidelines of the Bank's regulatory authority, the CBB, was 14.0 per cent at the 2006 year end. Under the CBB's guidelines, GCC governments are accorded the same preferential risk weighting as for OECD governments while GCC government-owned companies are accorded a preferential 20 per cent risk weighting. The CBB applies a minimum risk asset ratio of 12 per cent compared to a minimum of 8 per cent prescribed by the Basel Committee.

The Group's policies in relation to capital management are set out in note 23 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 24 to the consolidated financial statements. Further assessment of asset quality can be facilitated by reference to note 33 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 2006 were not significantly different to their net book values. All non-trading securities are classified as

Available-for-sale securities rating profile



	US$ millions	%
AAA/Aaa rated debt securities	1,750.4	20.8
Debt securities of other investment grade issuers	5,670.4	67.4
Other debt securities	196.2	2.3
Structured finance investments	717.6	8.5
Equities and equity funds	88.3	1.0
Total	**8,422.9**	**100.0**

available-for-sale and measured at fair value. Available-for-sale securities are accordingly stated at fair value in the consolidated balance sheet.

At the 2006 year end, available-for-sale securities accounted for 34.0 per cent of total assets while loans and advances represented 32.9 per cent.

Available-for-Sale Securities

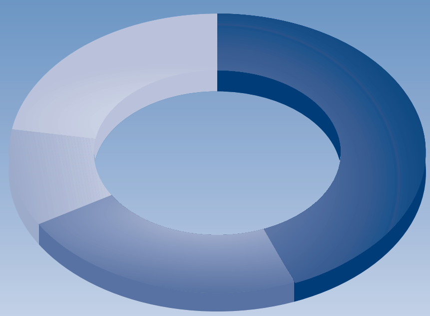
Available-for-sale (AFS) securities totalled US$8,422.9 million at 31st December 2006. The available-for-sale securities portfolio represents not only a substantial and effective liquidity reserve but also an effective international geographical diversification of the Group's risk assets with 78.9 per cent of the portfolio comprising securities of North American and European issuers. The remaining balance largely comprises securities issued by GCC country governments.

AFS securities comprise two types of debt security portfolios, structured finance investments 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 86.1 per cent of the total AFS securities portfolio at the 2006 year end. The smaller debt security portfolio comprises fixed income securities. This portfolio amounted to US$363.3 million at the end of 2006. This largely comprised GCC country government bonds with original maturities of up to two years.

Structured finance investments at 31st December 2006 amounted to US$717.6 million. This principally represents investments in specialised investment vehicles, the underlying investments of which largely comprise high quality investment grade-rated floating rate debt securities. The investments generate an attractive and stable margin over LIBOR by means of the leveraged characteristics of the investment vehicles. Equity and equity funds of US$88.3 million at the end of 2006 comprised private equity investments and externally managed funds providing a diversified exposure to the private equity sector.

An analysis of the AFS securities portfolio by rating category is set out in note 6(a) to the consolidated financial statements. US$1,750.4 million or 23.0 per cent of the AFS debt securities at the 2006 year end represented AAA / Aaa rated securities. Based on the rating of the issuer, a further US$5,670.4 million or 74.4 per cent of the AFS debt securities represented other investment grade-rated securities. Thus 97.4 per cent of the total debt securities comprised investment grade-rated securities. Other debt securities, the issuers of which are rated below BBB- / Baa3 or are unrated, amounted to US$196.2 million at the end of 2006, thus comprising only 2.6 per cent of the total AFS debt securities portfolio. The credit risk associated with these securities is rigorously monitored within the overall credit risk management process. The securities are therefore subject to the same stringent credit requirements as standard lending and credit-related contingent transactions.

Loan maturity profile



	US$ millions	%
Year 1	3,566.6	43.8
Years 2 & 3	1,836.4	22.5
Years 4 & 5	923.6	11.4
Over 5 years	1,818.4	22.3
Total	**8,145.0**	**100.0**

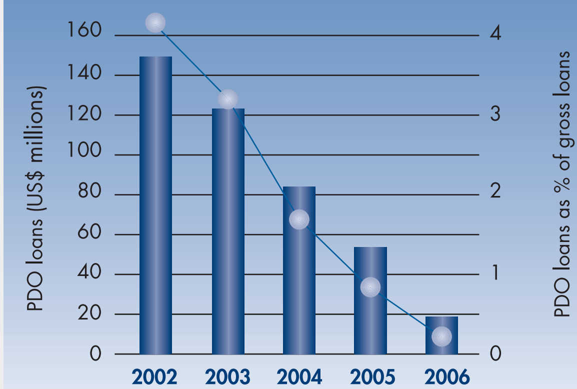
Loans and Advances

Loans and advances amounted to US$8,145.0 million at the 2006 year end. This represented a US$1,871.3 million or 29.8 per cent increase compared to the 2005 year end. The increase reflected further growth in the GCC loan portfolio and, in particular, project and structured finance-related facilities within the region, in line with the Group's strategic emphasis on relationship banking in the GCC. 91.7 per cent of the loan portfolio at the 2006 year end represented lending within GIB's core market in the GCC states. The geographical diversification of the Group's overall credit risk is achieved through the international securities markets rather than through participation in international syndicated lending transactions.

Based on contractual maturities at the balance sheet date, 43.8 per cent of the loan portfolio was due to mature within one year while 66.3 per cent was due to mature within three years. Only 22.3 per cent of loans were due to mature beyond five years. Details of the classification of loans and advances by industry is set out in note 7(a) to the consolidated financial statements while the geographical distribution of loans and advances is contained in note 24. At 31st December 2006, 31 per cent, or almost one third, of the loan portfolio comprised exposure to the energy, oil and petrochemical sector. This reflects the Group's strategic focus on project and structured finance, and syndicated lending in the GCC states.

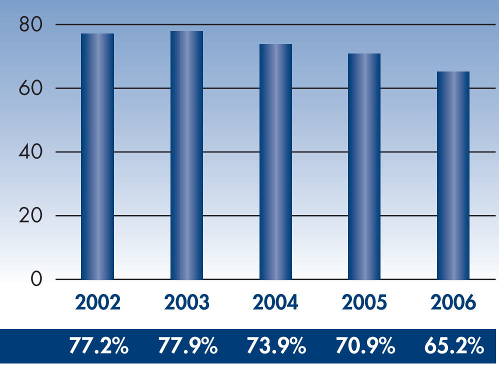
Total loan loss provisions at 31st December 2006 amounted to US$83.0 million. Counterparty specific provisions amounted to US$23.0 million while non-specific provisions were US$60.0 million. Specific provisions at the 2006 year end represented 70.7 per cent of loans against which a specific provision had been made. Specific provision utilisations during 2006 totalled US$21.4 million. The utilisations arose on the sale, settlement or write off of the related loans. While loans were sold or settled at less than the nominal values, the proceeds exceeded the provisioned net book values in all cases. There was a net loan provision release of US$0.8 million in 2006. The provision release was entirely attributable to releases arising on the sale or settlement of loans. There were no reductions in specific provisioning coverage during the year.

PDO loan development



	2002	2003	2004	2005	2006
PDO loans	149.4	123.2	84.0	53.7	18.7
% of gross loans	4.16%	3.20%	1.69%	0.84%	0.23%

Liquid assets ratio



Specific provisions are determined based on the recoverable amount of the loan. The recoverable amount is measured as the present value of the expected future cash flows discounted based on the interest rate at the inception of the facility. Non-specific provisions are determined on a portfolio basis utilising an incurred loss model. The incurred loss model estimates the probable losses inherent within the portfolio at the balance sheet date but that have not been specifically identified. The model is based on applicable credit ratings and associated historical default probabilities, loss severity and rating migrations, and reflects the current macroeconomic, political and business environment and other pertinent indicators.

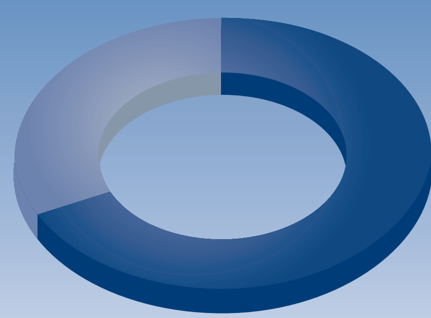
The gross and net book values of past due loans amounted to US$18.7 million and US$0.3 million respectively. The provisioning coverage for past due loans was therefore 98.4 per cent. Past due loans are defined as those loans for which either principal or interest is over 90 days past due. Under IAS 39, interest on impaired loans should be recognised in income based on the net book value of the loan and the interest rate that was used to discount the future cash flows for the purpose of measuring the recoverable amount. However, in accordance with guidelines issued by the Bank's regulator, the 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. An ageing analysis of past due loans is set out in note 7(c) to the consolidated financial statements. All past due loans were overdue by more than two years. There were no new past due loans during 2006. The gross volume of past due loans also continued to be substantially less than total provisions. Total provisions for loan losses exceeded the gross volume of past due loans by US$64.3 million. This means that rather than earnings being impaired by the funding cost of the net book value of past due loans, there is an earnings enhancement.

Other Asset Categories

Cash and other liquid assets, which amounted to US$268.2 million at the 2006 year end, are analysed in note 3 to the consolidated financial statements. In addition to cash and balances with banks, other liquid assets included certificates of deposit and Treasury bills held for balance sheet management purposes.

Placements with banks totalled US$4,322.5 million at the 2006 year end and were well diversified by geography as

Deposits - geographical profile



	US$ millions	%
GCC countries	11,484.3	68.1
Other countries	5,383.4	31.9
Total	**16,867.7**	**100.0**

illustrated in note 24 to the consolidated financial statements. Interbank placements were largely with GCC and European bank counterparties, representing the Group's two principal operating locations. Placements with banks represented 17.4 per cent of total assets at the 2006 year end contributing to a strong Liquid Assets Ratio of 65.2 per cent.

Trading securities at US$2,186.1 million largely comprised listed debt securities amounting to US$1,192.3 million and government bonds of US$534.0 million. Trading securities also included US$411.4 million of managed funds. The funds, which are managed by international institutions with acknowledged expertise in their field, provide diversified exposure to hedge funds, and equity and international debt markets.

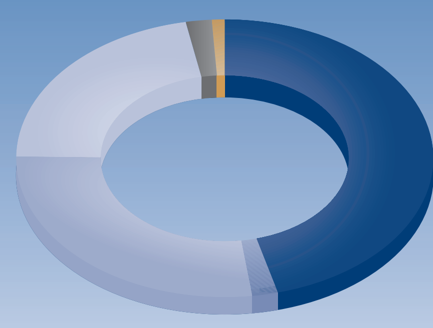
Risk Asset and Commitment Exposure

Risk asset and commitment exposure at 31st December 2006 amounted to US$28,390.1 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of other assets) and credit-related contingent items. As alluded to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 24 to the consolidated financial statements. An analysis of derivative and foreign exchange products is set out in note 27 while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 28.

FUNDING

Bank and customer deposits at 31st December 2006 totalled US$16,867.7 million. Customer deposits amounted to US$11,163.7 million at the 2006 year end being US$1,792.9 million higher than at the previous year end. Customer deposits represented 66.2 per cent, or over two thirds, of total deposits. The significant increase in customer deposits during 2006 reflected the high level of liquidity prevailing within the region. A US$1,612.3 million increase in bank deposits also reflected the high level of liquidity in the GCC interbank market. Funding was also enhanced by securities sold under agreements to repurchase (repos). Repos were US$2,219.6 million at 31st December 2006. The substantial volume of investment grade-rated AFS securities facilitates the Group's ability to fund through this mechanism. Repos represent a stable and cost effective source of funding, thereby enhancing both liquidity management and profitability. As illustrated in note 10 to the consolidated financial statements, 68.1 per cent or well over two thirds of total deposits were from the GCC. GIB is a net placer of funds in the international interbank market. Senior term financing at 31st December 2006 totalled US$1,867.1 million. A further increase in senior term finance is planned to take place in 2007. Further commentary on liquidity and funding is provided in the Risk Management Review.

Risk asset and commitment exposure



	US$ millions	%
GCC	13,052.1	45.9
Other Middle East & North Africa	560.2	2.0
North America	7,751.1	27.3
Europe	6,188.0	21.8
Asia	565.4	2.0
Latin America	273.3	1.0
Total	**28,390.1**	**100.0**

GIB offers a wide range of treasury and capital market products and services to a diverse client base consisting of regional corporations, conventional and Islamic financial institutions and government entities. The Bank also implements customised hedging strategies on behalf of its customers.

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

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

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

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

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

The major risks associated with the Group's business are credit, market, liquidity and operational risks. These risks and the related risk management processes are commented on in note 23 to the consolidated financial statements and are discussed in detail in the following sections.

CREDIT RISK

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

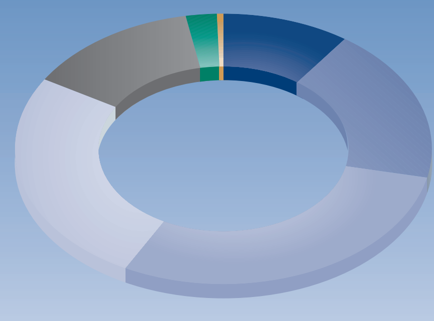
- entering netting agreements with counterparties that permit offsetting of receivables and payables.
- obtaining collateral against the Group's exposure.
- seeking third party guarantees of the counterparty's obligations.
- imposing restrictions and covenants on borrowers.

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each exposure, which affects the credit approval decision and the terms and conditions of the transaction. For cross border transactions an analysis of country risk is also conducted. The Group bases its credit decision for an individual counterparty on the aggregate Group exposure to that counterparty and all its related entities. Groupwide credit limit setting and approval authorisation requirements are conducted within Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Groupwide basis in a consistent manner.

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

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

Credit risk rating profile



	US$ millions	%
AAA/Aaa	2,751.6	9.9
AA/Aa	5,180.9	18.5
A/A	8,235.4	29.4
BBB/Baa	7,208.2	25.8
BB/Ba	3,767.4	13.5
B/B	658.9	2.4
Below B/B	127.9	0.5
Total	**27,930.3**	**100.0**

Derivative contracts may also carry legal risk, the Group seeks to minimise these risks by the use of standard contract agreements. The current gross positive market values or credit risk amounts of foreign exchange and derivative transactions are set out in note 27 to the consolidated financial statements. The total credit risk amount in respect of all such transactions outstanding at the 2006 year end amounted to US$67.5 million before taking account of the risk-reducing benefits of any collateral held or legally enforceable netting agreements. Transactions maturing beyond one year represented either hedging transactions entered into for asset and liability management purposes or fully offset customer transactions.

MARKET RISK

Market risk is the risk of loss of value of a financial instrument or a portfolio of financial instruments as a result of changes in market prices and rates. Market risk arises from the Group's trading, asset and liability management and investment activities. A description of the categories of market risk faced by the Group is set out below:

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

The Group seeks to manage the market risks it faces through diversification of exposures across dissimilar markets and establishment of hedges in related securities or off balance sheet derivative instruments. To manage the Group's exposures in addition to the exercise of business judgment and management experience, the Group utilises limit structures including those relating to positions, portfolios, maturities and maximum allowable losses.

A key element in the Group's market risk management framework is the estimation of potential future losses that may arise from adverse market movements. The Group utilises Value-at-Risk (VaR) to estimate such losses. The 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. The VaR takes account of potential diversification benefits of different positions both within and across different portfolios. Consistent with general market practice, VaR is computed for all financial instruments for which there are readily available daily prices or a suitable proxy.

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

For internal risk management purposes, the Group measures losses that are anticipated to occur within a 95 per cent confidence level. The Group measures VaR utilising a one month assumed holding period for both trading and available-for-sale positions.

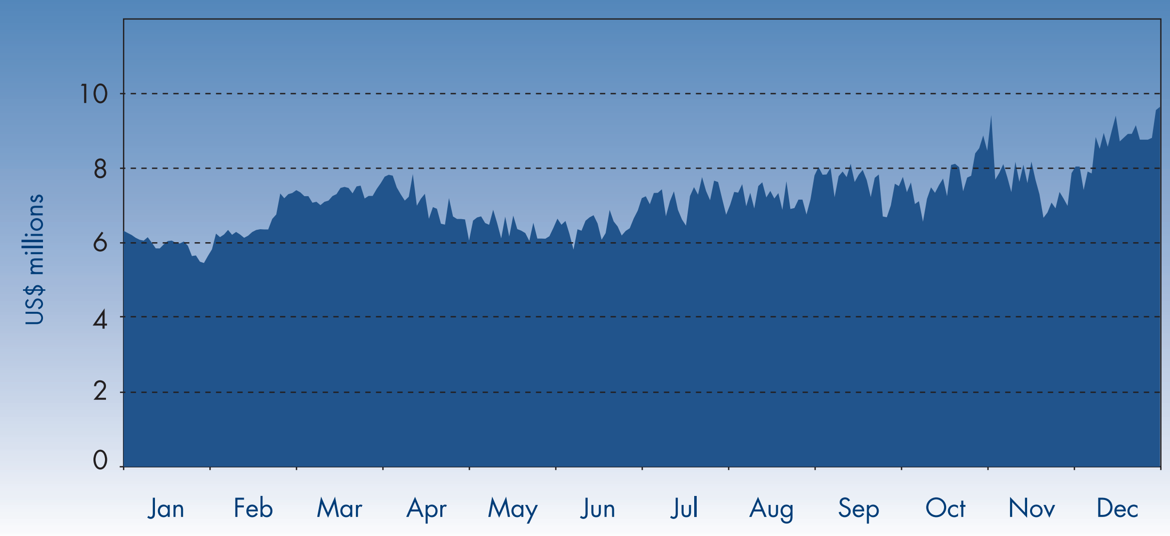
The graph on the next page sets out the total Value-at-Risk for all the Group's trading activities at the close of each business day throughout the year. The figures are calculated using the regulatory VaR basis at a 1 per cent risk level (2.33 standard deviations) and at the ten-day horizon using one-year unweighted historical daily movements in market rates and prices. On this basis, total diversified VaR over the year averaged US$7.3 million and varied within the range of US$5.6 million to US$9.9 million with a 2006 year-end value of US$9.9 million.

The Group conducts daily VaR back testing both for regulatory compliance with the Basel Committee on Banking Supervision market risk capital rules and for internal evaluation of VaR against trading profits and losses. During 2006, there were no occasions on which a daily trading loss exceeded the trading VaR at the close of business on the previous business day. The Basel Committee's guidelines on back testing permit a maximum of five excesses beyond which the multiplication factor determined by the regulator may be increased.

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (i.e. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are designed to estimate the potential economic losses in such abnormal markets. Therefore, stress testing combined with VaR provides a more comprehensive picture of market risk. The Group regularly performs stress tests that are constructed around changes in market rates and prices resulting from pre-defined market stress scenarios, including both historical and hypothetical market events. Historical scenarios include the 1997 Asian crisis, the 1998 Russian crisis and the Summer 2002 corporate scandals. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability re-pricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rates. The asset and liability re-pricing profile and details of the effective interest rates prevailing at the year-end on the various asset and liability categories are set out in note 26 to the consolidated financial statements. The re-pricing profiles of individual asset and liability categories incorporate the effect of interest rate swaps used to modify the interest rate

Trading Value-at-Risk daily development



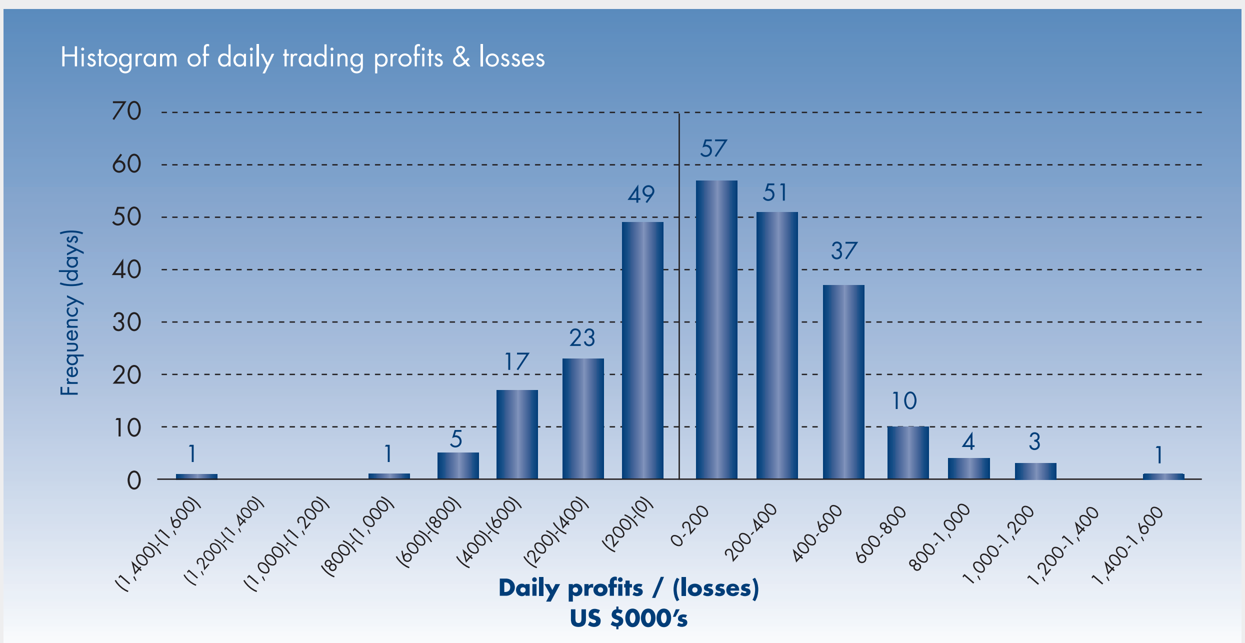
characteristics of specific transactions. As illustrated in note 26, the substantial majority of assets and liabilities re-price within one year. Interest rate exposure beyond one year amounted to only US$437 million or 1.8 per cent of total assets. This exposure represented the investment of the net free capital funds in fixed rate government securities and fixed receive interest rate swaps. At 31st December 2006 the modified duration of these fixed rate government securities and interest rate swaps was 5.95.

OPERATIONAL RISK

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

Whilst operational risk cannot be eliminated in its entirety, the Group endeavours to minimise it by ensuring that a strong control infrastructure is in place throughout the organisation. The various procedures and processes used to manage operational risk include effective staff training, appropriate controls to safeguard assets and records, regular reconciliation of accounts and transactions, close monitoring of risk limits, segregation of duties, and financial management and reporting. In addition, other control strategies, including business continuity planning and insurance, are in place to complement the procedures, as applicable.

The Group's Operational Risk Management Framework (ORMF), in line with Basel II requirements, is being implemented for the Standardised Approach. As part of the 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 being built and maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk.



Client assets under management grew to US$21.7 billion and have almost doubled in the past three years, reinforcing GIB's status as the largest commercial local manager of client assets in the Middle East.

GOVERNANCE

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

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

ORGANISATION

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

- There is an effective and appropriately constituted Board of Directors responsible for the stewardship of the Bank and the supervision of the Bank's business, that receives from management such information as is required to properly fulfill its duties and the duties of the committees that assist it, and that delegates to management the authority and responsibility for day-to-day business;
- There is an effective and appropriately organised management structure responsible for the day-to-day management of the Bank and the implementation of Board-approved strategy, policies and internal controls;
- There is a division of roles and responsibilities as between the Board of Directors and the Chief Executive Officer; and
- There are defined and documented mandates and responsibilities (as well as delegated authorities, where applicable) for:
  - The Board,
  - The Chairman of the Board,
  - The Board committees (the Audit Committee, the Risk Policy Committee and the Human Resources & Compensation Committee),
  - The Management,
  - The Chief Executive Officer, and
  - The five management committees (the Management Committee, the Group Risk Committee, the Assets & Liabilities Committee, the Information Security Management Committee and the Human Resources Committee).

BOARD OF DIRECTORS

The Board comprises nine non-executive directors, including the Chairman and Vice-Chairman, who together bring a wide range of skills and experience to the Board. Their biographies are set out on page 76.

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

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

The Board is responsible for the strategic direction of the Bank; maintaining an appropriate organisation structure; approving major policies; monitoring business performance, operations and the integrity of internal controls; nurturing proper and ethical behaviour; providing appropriate oversight and conducting corporate governance in a transparent manner.

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

In preparation for Board and Committee meetings, the directors receive in a timely manner regular reports and all other information required for such meetings, supplemented by any additional information specifically requested by the directors from time to time. The directors also receive monthly financial reports and other regular management reports that enable them to evaluate the Bank's and management's performance against agreed objectives.

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

In 2006, the Board met six times, the Audit Committee met four times, the Human Resources & Compensation Committee met six times, and the Risk Policy Committee met twice.

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

MANDATES OF THE BOARD COMMITTEES

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

Audit Committee:

- Assists the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices.
- Assists the Board in its oversight of (i) the integrity and reporting of the Bank's quarterly and annual financial statements, (ii) compliance with legal and regulatory requirements; and (iii) the independence and performance of the Bank's internal and external auditors.
- Assists the Board in ensuring that an adequate, effective, comprehensive and transparent corporate governance process is in place.

THE BOARD OF DIRECTORS & ITS COMMITTEES

Board and committee meetings attendance during 2006

Board Members	Board meetings	Audit Committee meetings	HR/Compensation Committee meetings	Risk Policy Committee meetings
H.E. Sheikh Ebrahim Bin Khalifa Al Khalifa - Chairman *(Kingdom of Bahrain)*	6 (6)			
Mr. Abdul Aziz M. Al-Abdulkader - Vice Chairman *(Saudi Arabian Monetary Agency)*	6 (6)			2 (2)*
Mr. Bader Abdullah Al-Rushaid Al-Bader *(State of Kuwait)*	5 (6)			2 (2)
Dr. Hamad Bin Sulaiman Al-Bazai *(Kingdom of Saudi Arabia)*	6 (6)	4 (4)*	6 (6)*	
Mr. Saud Bin Nassir Al-Shukaily *(Sultanate of Oman)*	6 (6)	4 (4)		
Mr. Khalid Bin Abdulla Al-Suwaidi *(State of Qatar)*	6 (6)		6 (6)	
Mr. Nasser Khamis Al-Suwaidi *(The United Arab Emirates)*	6 (6)	4 (4)	6 (6)	
Dr. Khalid Bin Abdulla Al-Sweilem *(Saudi Arabian Monetary Agency)*	6 (6)	4 (4)		2 (2)
Dr. Abdul Rahman Bin Ahmed Al-Jafary *(Saudi Arabian Monetary Agency)*	6 (6)		6 (6)	2 (2)

* Committee Chairman

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

- Recommends to the Board the selection and compensation of the Bank's external auditors (for appointment and approval at the shareholders' annual General Assembly), and ensures their independence.
- Reviews the activities and performance of the internal audit function.
- Reviews and supervises the implementation and enforcement of the Bank's Code of Conduct.
- Maintains an open avenue of communication among the Board of Directors, the Bank's management, and the Bank's internal and external auditors.

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

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

The Head of Compliance, who reports to the Chief Executive Officer, also has access to the Board of Directors through the Audit Committee, if required.

Risk Policy Committee:

- Assists the Board in fulfilling its oversight responsibilities with respect to setting the Bank's overall risk appetite, parameters and limits within which it conducts its activities.
- Ensures that the Bank has an effective risk management framework in place and that all risk controls operating throughout the Bank are in accordance with regulatory requirements and best practice standards for management of risks in banks.
- Ensures that realistic policies in respect of management of all significant risks are drafted and approved appropriately.
- Reviews the Bank's risk profile and significant risk positions.
- Approves with management the overall credit risk policy limits.
- Receives, reviews, challenges and recommends for approval, by the full Board, any proposed amendments to the overall risk appetite for the Bank.
- Ensures that roles and responsibilities for risk management are clearly defined, and that they remain independent of business development.
- 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 action taken to address such findings.
- Ensures that management reports significant excesses and exceptions, as and when they arise, to the Committee for information and review.
- Monitors whether management maintains a culture that rewards the recognition, communication and management of risks.

Human Resources & Compensation Committee:

- Assists the Board in fulfilling its responsibilities for the Bank's human resources and remuneration policies.
- Reviews the Bank's human resources and compensation policy proposals, and makes the necessary recommendations in that regard for approval by the Board.
- Ensures that the Bank's remuneration levels remain competitive for the Bank to continue to attract, retain and motivate competent staff to achieve the strategy and objectives of the Bank.
- Monitors the overall cost of remuneration structures of the Bank.
- Ensures that effective management systems are in place to monitor and evaluate the performance of staff.
- Reviews the Bank's succession plan report for submission to the regulators.

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

- a fixed component representing basic pay, allowances and benefits; and

- a variable component representing a performance-related award linked to the performance of the Bank, the contribution of the relevant unit and the individual's personal performance.

THE MANAGEMENT

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

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

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

STRATEGY & OBJECTIVES

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

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

DISCLOSURES & WEBSITE

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

The Bank's website (www.gibonline.com) also provides substantial information on the Bank, including all its press releases, its strategy statement and its Code of Conduct.

GIB CODE OF CONDUCT

The Board of Directors has adopted a Code of Conduct, with rules on conduct, ethics and on avoiding conflicts of interest, applicable to all the employees and directors of the Bank.

The Code of Conduct is designed to guide all employees and directors through best practices to fulfill their responsibilities and obligations towards the Bank's stakeholders (shareholders, clients, staff, regulators, suppliers, the public, 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; speaking up and whistleblowing.

Contents

REPORT OF THE AUDITORS TO THE SHAREHOLDERS

Report on the consolidated financial statements

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 balance sheet as at 31st December 2006, and the consolidated statement of income, the consolidated statement of cash flows and the consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Responsibility of the directors for the consolidated financial statements

The directors of the Bank are responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatements, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements 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 entity's internal controls. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31st December 2006, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other legal and regulatory requirements

In addition, in our opinion, the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying Chairman's Statement and confirm that the information contained therein is consistent with the consolidated financial statements. We are not aware of any violations of the Bahrain Commercial Companies Law 2001, the Central Bank of Bahrain and Financial Institutions Law 2006, terms of the Bank's licence or its memorandum and articles of association having occurred during the year ended 31st December 2006 that might have had a material effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by the management in response to all our requests.

KPMG.

KPMG
Public Accountants
Manama, Kingdom of Bahrain
31st January 2007

CONSOLIDATED BALANCE SHEET

	Note	At 31.12.06 US$ millions	At 31.12.05 US$ millions
Assets			
Cash and other liquid assets	3	**268.2**	345.4
Due from brokers		**950.9**	942.2
Placements with banks	4	**4,322.5**	5,079.7
Trading securities	5	**2,186.1**	2,007.5
Available-for-sale securities	6	**8,422.9**	7,839.6
Loans and advances	7	**8,145.0**	6,273.7
Other assets	8	**491.6**	368.5
Total assets		**24,787.2**	22,856.6
Liabilities			
Deposits from banks	10	**5,704.0**	4,091.7
Deposits from customers	10	**11,163.7**	9,370.8
Securities sold under agreements to repurchase	11	**2,219.6**	3,711.5
Securities sold but not yet purchased		**862.7**	873.5
Other liabilities	12	**563.5**	596.3
Senior term financing	13	**1,867.1**	1,944.5
Subordinated term financing	14	**550.0**	550.0
Total liabilities		**22,930.6**	21,138.3
Equity			
Share capital	15	**1,000.0**	1,000.0
Share premium		**7.6**	7.6
Reserves	16	**365.9**	334.6
Retained earnings		**483.1**	376.1
Total equity		**1,856.6**	1,718.3
Total liabilities & equity		**24,787.2**	22,856.6

The consolidated financial statements were approved by the Board of Directors on 31st January 2007 and signed on their behalf by:-

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 41 to 74 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

	Note	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
Interest income	18	**1,235.8**	750.8
Interest expense	18	**978.1**	541.8
Net interest income		**257.7**	209.0
Provisions for securities	6	**(1.6)**	14.0
Provisions for loans and advances	7	**(0.8)**	(11.8)
Net interest income after provisions		**260.1**	206.8
Fee and commission income	19	**65.8**	46.2
Trading income	20	**48.2**	43.6
Profits on available-for-sale securities		**28.8**	45.6
Other income	21	**4.9**	3.8
Total income		**407.8**	346.0
Staff expenses		**101.9**	101.7
Premises expenses		**8.2**	7.6
Other operating expenses		**33.9**	29.4
Operating expenses		**144.0**	138.7
Net income before tax		**263.8**	207.3
Taxation charge on overseas activities		**8.3**	4.3
Net income after tax		**255.5**	203.0
Earnings per share	*34*	***US$0.26***	*US$0.20*

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 41 to 74 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
Operating activities		
Net income after tax	**255.5**	203.0
Adjustments to reconcile net income to net cash outflow from operating activities:		
Provisions for securities	**(1.6)**	14.0
Provisions for loans and advances	**(0.8)**	(11.8)
Profit on available-for-sale securities	**(28.8)**	(45.6)
Amortisation of available-for-sale securities	**2.9**	1.7
Increase in accrued interest receivable	**(66.7)**	(87.2)
Increase in accrued interest payable	**15.6**	65.5
(Increase) / decrease in other net assets	**(60.6)**	90.8
Net increase in trading securities	**(178.6)**	(395.1)
Net cash outflow from operating activities	**(63.1)**	(164.7)
Investing activities		
Net increase in due from brokers	**(8.7)**	(350.8)
Net decrease / (increase) in placements with banks	**757.2**	(1,793.2)
Net increase in loans and advances	**(1,870.5)**	(1,414.8)
Purchase of available-for-sale securities	**(1,730.1)**	(1,503.0)
Sale and maturity of available-for-sale securities	**1,114.4**	2,087.2
Net cash outflow from investing activities	**(1,737.7)**	(2,974.6)
Financing activities		
Net increase / (decrease) in deposits from banks	**1,612.3**	(654.5)
Net increase in deposits from customers	**1,792.9**	3,202.2
Net decrease in securities sold under agreements to repurchase	**(1,491.9)**	(107.3)
Net (decrease) / increase in securities sold but not yet purchased	**(10.8)**	308.6
Net (decrease) / increase in senior term financing	**(77.4)**	266.2
Net increase in subordinated term financing	**-**	400.0
Dividends paid	**(101.5)**	(75.1)
Net cash inflow from financing activities	**1,723.6**	3,340.1
(Decrease) / increase in cash and cash equivalents	**(77.2)**	200.8
Cash and cash equivalents at 1st January	**345.4**	144.6
Cash and cash equivalents at 31st December	**268.2**	345.4

The notes on pages 41 to 74 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Share capital US$ millions	Share premium US$ millions	Reserves US$ millions	Retained earnings US$ millions	Total US$ millions
At 1st January 2005	**1,000.0**	**7.6**	**289.8**	**289.2**	**1,586.6**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	15.0	-	15.0
- Cash flow hedges:					
net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(8.2)	-	(8.2)
Net gains recognised directly in equity	-	-	3.8	-	3.8
Dividend for 2004	-	-	-	(75.1)	(75.1)
Net income for the year	-	-	-	203.0	203.0
Transfers from retained earnings	-	-	41.0	(41.0)	-
At 31st December 2005	**1,000.0**	**7.6**	**334.6**	**376.1**	**1,718.3**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	0.7	-	0.7
- Cash flow hedges:					
net fair value losses	-	-	(2.0)	-	(2.0)
Transfers in the year:-					
- Transfers to net income	-	-	(14.4)	-	(14.4)
Net losses recognised directly in equity	-	-	(15.7)	-	(15.7)
Dividend for 2005	-	-	-	(101.5)	(101.5)
Net income for the year	-	-	-	255.5	255.5
Transfers from retained earnings	-	-	47.0	(47.0)	-
At 31st December 2006	**1,000.0**	**7.6**	**365.9**	**483.1**	**1,856.6**

The notes on pages 41 to 74 form part of these consolidated financial statements.

For the year ended 31st December 2006

1. INCORPORATION AND REGISTRATION

The parent company of the Group (the Group), Gulf International Bank B.S.C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No.30 dated 24th November 1975 and is registered as 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 Group is principally engaged in the provision of wholesale commercial and investment banking services. The Group operates through subsidiaries, branch offices and representative offices located in six countries worldwide. The total number of staff employed by the Group at the end of the financial year was 593.

2. ACCOUNTING POLICIES

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

2.1 Basis of presentation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and in conformity with the Bahrain Commercial Companies Law and the 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, available-for-sale securities, securities sold but not yet purchased, and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year except for changes resulting from amendments to International Accounting Standard (IAS) No. 1 - Presentation of Financial Statements: Capital Disclosures and IAS 19 - Employee Benefits as described in more detail below.

The amendment to IAS 1 - Presentation of Financial Statements: Capital Disclosures, which has been adopted prior to its effective date of 1st January 2007, introduced new disclosure requirements in respect of the management of capital. The relevant disclosure is set out in note 23 to the consolidated financial statements. The amendment had no impact on the Group's consolidated net income or financial position. In accordance with the transitional requirements of the amendment, full comparative information has been disclosed.

During the year, the Group adopted the amendments to IAS 19 - Employee Benefits, which increased the level of disclosure in respect of defined benefit pension plans. The amendments had no impact on the Group's consolidated net income or financial position. In accordance with the transitional requirements of the amendments, full comparative information has been disclosed.

2.2 Consolidation principles

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

2.3 Use of estimates and assumptions

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amount of financial assets and liabilities at the balance sheet date. The use of estimates and assumptions is principally limited to the determination of impairment provisions for loans and available-for-sale securities, and the valuation of the Group's defined benefit pension plan. The estimates and assumptions relating to provisions for impairment are described in more detail in note 2.14 to the consolidated financial statements. The principal actuarial assumptions for the defined benefit pension plan are set out in note 9 to the consolidated financial statements.

2. ACCOUNTING POLICIES (continued)

2.4 Trade and settlement date accounting

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

2.5 Foreign currencies

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

2.6 Offsetting

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

2.7 Derecognition of financial assets and liabilities

Financial assets are derecognised and removed from the balance sheet when the right to receive cash flows from the assets has expired; the Group has transferred its contractual right to receive the cash flows from the assets, and substantially all the risks and rewards of ownership; or where control is not retained. Financial liabilities are derecognised and removed from the balance sheet when the obligation is discharged, cancelled or expires.

2.8 Revenue recognition

a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial instruments except those classified as held for trading 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 instrument 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 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.

2. ACCOUNTING POLICIES (continued)

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 income

Trading income arises 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.

d) Dividend income

Dividend income is recognised as follows:-

- dividends from structured finance investments are recognised on an accruals basis and are included in interest income. The structured finance investments are in the form of capital notes and the underlying investments comprise high quality, investment-grade rated debt securities.
- dividends from equity instruments classified as held for trading are recognised when the right to receive payment is established and are included in trading income.
- dividends from equity instruments classified as available for sale are recognised when the right to receive payment is established and are included in other income.
- in the separate financial statements of the Bank, dividends from subsidiaries are recognised when received.

2.9 Securities financing arrangements

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

2.10 Securities

Securities which are either acquired for the purpose of generating a profit from short-term fluctuations in price or are included in a portfolio in which a pattern of short-term profit taking exists are categorised as trading securities. Trading securities are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses together with interest earned on trading securities are included in trading income.

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

Dividends received on trading and available-for-sale equity instruments are included in trading income and other income respectively.

2. ACCOUNTING POLICIES (continued)

2.11 Loans and advances

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

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

2.12 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. Where the carrying amount of premises or equipment is greater than the estimated recoverable amount, the carrying amount is reduced to the recoverable amount.

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

2.13 Financial liabilities

Financial liabilities incurred for the purpose of generating a profit in the short term (securities sold but not yet purchased) are categorised as held-for-trading liabilities. Liabilities categorised as held for trading are initially recognised at fair value, including transaction costs, and subsequently measured at fair value based on quoted market prices. Realised and unrealised gains and losses together with interest incurred on trading liabilities are included in trading income. All other financial liabilities are measured at amortised cost using the effective interest rate method as described in note 2.8.

2.14 Provisions for impairment

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

Provisions for impairment are also measured and recognised on a 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.

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

2.15 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. ACCOUNTING POLICIES (continued)

2.16 Derivative financial instruments

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

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

The changes in the fair values of derivative financial instruments entered into for trading purposes or to hedge other trading positions are included in 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,
- the effectiveness of the hedge must be capable of being reliably measured, and
- the hedge must be assessed on an ongoing basis and determined to have actually been highly effective throughout the financial reporting period.

Changes in the fair values of derivative financial instruments that are designated, and qualify, as fair value hedges and that prove to be highly effective in relation to the hedged risk, are included in 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 balance sheet. If the hedge no longer meets the criteria for hedge accounting, any adjustment to the carrying amount of a hedged interest-bearing financial instrument is amortised to income over the remaining period to maturity.

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

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

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

2. ACCOUNTING POLICIES (continued)

2.17 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, and the present value of any expected financial obligation arising as a result of an anticipated non-recoverable payment under a guarantee. Any increase in a liability relating to guarantees is included in the provision charge in the consolidated statement of income. Financial guarantees are included in other liabilities.

2.18 Post retirement benefits

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

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

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

Actuarial gains and losses are recognised in income when the net cumulative unrecognised actuarial gain or loss at the end of the previous financial year exceeds 10 per cent of the higher of: (i) the fair value of the plan assets, and (ii) the present value of the fund obligations. That portion of the net cumulative unrecognised actuarial gain or loss is recognised in income over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

2.19 Deferred income taxes

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

2.20 Cash and cash equivalents

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

2.21 Segment reporting

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

2.22 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. ACCOUNTING POLICIES (continued)

2.23 Comparatives

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

2.24 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 2006. The relevant new standards, amendments to standards, and interpretations, are as follows:-

- IFRS 7 - Financial Instruments: Disclosures. IFRS 7 becomes effective for financial years beginning on or after 1st January 2007. This standard prescribes the disclosure requirements related to financial instruments and supersedes IAS 30 - Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements in IAS 32 - Financial Instruments: Disclosure and Presentation.
- IFRIC 9 - Reassessment of Embedded Derivatives. IFRIC 9 becomes effective for financial years beginning on or after 1st June 2006. This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract with reassessment only if there is a change to the contract that significantly modifies the cash flows. The adoption of this interpretation is not expected to have any impact on the consolidated financial statements.
- IFRIC 10 - Interim Financial Reporting and Impairment. IFRIC 10 becomes effective for financial years beginning on or after 1st November 2006. This interpretation prohibits the reversal of provisions for impairment recognised in a previous interim period in respect of goodwill, an investment in an equity instrument, or a financial asset carried at cost. The adoption of this interpretation is not expected to have any impact on the consolidated financial statements

3. CASH AND OTHER LIQUID ASSETS

	31.12.06 US$ millions	31.12.05 US$ millions
Cash and balances with banks	**117.6**	82.6
Certificates of deposit	**150.0**	233.4
Securities purchased under agreements to resell	**-**	28.8
Treasury bills	**0.6**	0.6
	268.2	345.4

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

4. PLACEMENTS WITH BANKS

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

Placements with banks at 31st December 2006 included placements with non-bank financial institutions amounting to US$54.6 million (2005: US$171.6 million).

For the year ended 31st December 2006

5. TRADING SECURITIES

	31.12.06 US$ millions	31.12.05 US$ millions
Government bonds and bills	**534.0**	514.3
Listed debt securities	**1,192.3**	1,164.7
Unlisted debt securities	**-**	8.1
Managed funds	**411.4**	262.3
Equities	**48.4**	58.1
	2,186.1	2,007.5

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

6. AVAILABLE-FOR-SALE SECURITIES

a) Classification of available-for-sale securities

	31.12.06 US$ millions	31.12.05 US$ millions
AAA/Aaa rated debt securities	**1,750.4**	1,503.2
Debt securities of other investment grade issuers	**5,670.4**	5,402.1
Other debt securities	**196.2**	196.8
Structured finance investments	**717.6**	677.4
Equities and equity funds	**88.3**	60.1
	8,422.9	7,839.6

The Group's available-for-sale securities predominantly comprise higher quality, investment grade-rated debt securities. At 31st December 2006, 97.4 per cent of available-for-sale debt securities were investment grade-rated (2005: 97.2 per cent).

Structured finance investments represent investments in special purpose vehicles managed by international investment banks, the underlying investments of which principally comprise high quality, investment-grade rated debt securities. The investments are in the form of capital notes and the returns are based on LIBOR plus margin.

Debt securities of other investment grade issuers at 31st December 2006 included GCC country government securities of US$479.1 million (2005: US$538.5 million).

b) Provisions for impairment

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

	2006 US$ millions	2005 US$ millions
At 1st January	**71.6**	90.7
Exchange rate movements	**1.0**	(3.4)
Amounts utilised	**(7.1)**	(29.7)
(Release)/charge for the year	**(1.6)**	14.0
At 31st December	**63.9**	71.6

6. AVAILABLE-FOR-SALE SECURITIES (continued)

c) Unquoted equity investments

Available-for-sale securities at 31st December 2006 included US$81.4 million (2005: US$50.5 million) of unquoted equity investments for which fair values cannot be reliably measured. These investments are stated at cost less provision for impairment. They principally comprise investments in managed entities, the underlying investments of which are primarily of either a corporate debt or private equity nature, managed by external specialist managers and international investment banks. There are no active markets or other appropriate methods from which to derive reliable fair values for these investments. The Group intends to exit these investments principally by means of IPOs or private placements.

7. LOANS AND ADVANCES

	31.12.06 US$ millions	31.12.05 US$ millions
Gross loans and advances	**8,228.0**	6,378.6
Provisions for impairment	**(83.0)**	(104.9)
Net loans and advances	**8,145.0**	6,273.7

Gross loans and advances at 31st December 2006 included loans held for trading of US$12.7 million (2005: US$27.5 million).

a) Industrial classification

The classification of loans and advances by industry was as follows:-

	31.12.06 US$ millions	31.12.05 US$ millions
Energy, oil and petrochemical	**2,523.6**	1,818.8
Trading and services	**1,524.1**	941.5
Financial services	**1,428.1**	1,207.7
Construction	**607.0**	530.8
Manufacturing	**594.8**	580.5
Transportation	**467.9**	442.0
Communication	**321.3**	248.0
Government	**299.0**	212.3
Other	**462.2**	397.0
	8,228.0	6,378.6
Provisions for impairment	**(83.0)**	(104.9)
	8,145.0	6,273.7

The classification of loans and advances by industry reflects the Group's strategic focus on project and structured finance and syndicated lending in the Gulf Cooperation Council (GCC) states.

7. LOANS AND ADVANCES (continued)

b) Provisions for impairment

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

	2006 US$ millions	2005 US$ millions
At 1st January	**104.9**	569.6
Decrease arising on the transfer of impaired loans off-balance sheet	**-**	(448.7)
Exchange rate movements	**0.3**	(1.9)
Amounts utilised	**(21.4)**	(2.3)
Release for the year	**(0.8)**	(11.8)
At 31st December	**83.0**	104.9

Total specific provisions at 31st December 2006 represented 70.7 per cent (2005: 73.8 per cent) of loans against which a specific provision had been made. Total provisions at 31st December 2006 exceeded the gross book value of past due loans by US$64.3 million (2005: US$51.2 million).

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

Amounts utilised during 2006 of US$21.4 million (2005: US$2.3 million) represented provisions utilised on the sale, settlement or write off of the related loans.

At 31st December 2006 there was no accrued but uncollected interest on impaired loans included in interest income (2005: nil).

c) Past due loans

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

	31.12.06		31.12.05	
	Gross US$ millions	**Net book value** US$ millions	Gross US$ millions	Net book value US$ millions
Corporate	**8.4**	**0.3**	40.4	5.5
Financial institutions	**10.3**	**-**	12.6	-
Sovereign	**-**	**-**	0.7	0.5
	18.7	**0.3**	53.7	6.0

7. LOANS AND ADVANCES (continued)

c) Past due loans (continued)

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

	31.12.06 US$ millions	31.12.05 US$ millions
7 months to 1 year	**-**	2.8
2 to 5 years	**18.7**	43.3
Over 5 years	**-**	7.6
	18.7	53.7

At 31st December 2006 uncollected interest-in-suspense on past due loans amounted to US$1.4 million (2005: US$3.3 million).

8. OTHER ASSETS

	31.12.06 US$ millions	31.12.05 US$ millions
Accrued interest, fees and commissions	**338.7**	272.0
Derivative financial instruments	**42.5**	36.4
Premises and equipment	**32.5**	17.1
Outstanding security settlements	**30.0**	7.9
Deferred items	**7.7**	10.0
Prepayments	**10.5**	7.6
Other, including accounts receivable	**29.7**	17.5
	491.6	368.5

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 27(d).

9. POST RETIREMENT BENEFITS

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

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31st December 2006 amounted to US$5.5 million (2005: US$4.6 million).

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

9. POST RETIREMENT BENEFITS (continued)

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

	31.12.06 US$ millions	31.12.05 US$ millions
Fair value of plan assets	**132.5**	105.9
Present value of fund obligations	**161.7**	138.1
	29.2	32.2
Unrecognised actuarial loss	**21.9**	30.7
Net liability in the consolidated balance sheet	**7.3**	1.5

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

	2006 US$ millions	2005 US$ millions
At 1st January	**105.9**	100.0
Expected return on plan assets	**7.4**	6.4
Contributions paid by the Group	**2.4**	2.3
Benefits paid by the plan	**(2.3)**	(1.8)
Actuarial gains	**3.1**	10.9
Exchange rate movements	**16.0**	(11.9)
At 31st December	**132.5**	105.9

The plan assets at 31st December 2006 comprise equity and debt securities in the ratio of 85 per cent and 15 per cent respectively (2005: 84 per cent and 16 per cent respectively).

The expected and actual returns on the plan assets for the year ended 31st December 2006 were US$7.4 million and US$10.2 million respectively (2005: US$6.4 million and US$15.6 million respectively). The overall expected rate of return on the plan assets is determined based on market prices, applicable to the period over which the obligation is to be settled. The expected return is determined separately for equity and debt securities.

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

	2006 US$ millions	2005 US$ millions
At 1st January	**138.1**	134.4
Current service cost	**3.8**	4.0
Interest cost	**7.0**	6.7
Actuarial (gains) / losses	**(4.7)**	10.5
Benefits paid by the plan	**(2.3)**	(1.8)
Exchange rate movements	**19.8**	(15.7)
At 31st December	**161.7**	138.1

9. POST RETIREMENT BENEFITS (continued)

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

	2006 **US$ millions**	2005 US$ millions
At 1st January	**(1.5)**	2.1
Net expense included in staff expenses	**(5.5)**	(6.2)
Contributions paid by the Group	**2.4**	2.3
Exchange rate movements	**(2.7)**	0.3
At 31st December	**(7.3)**	(1.5)

The Group paid US$2.4 million in contributions to the plan during 2006 and expects to pay US$3.6 million during 2007.

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

	2006 **US$ millions**	2005 US$ millions
Current service cost	**3.8**	4.0
Interest cost	**7.0**	6.7
Expected return on plan assets	**(7.4)**	(6.4)
Losses on curtailments and settlements	**-**	0.2
Amortisation of actuarial loss	**2.1**	1.7
Net expense included in staff expenses	**5.5**	6.2

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

	2006	2005
Discount rate	**5.1%**	4.9%
Expected return on plan assets - equities	**7.4%**	7.4%
Expected return on plan assets - bonds	**4.9%**	4.4%
Future salary increases	**3.9%**	4.4%
Future increases to pensions in payment	**2.8%**	2.9%

g) Historical information

	2006 **US$ millions**	2005 US$ millions	2004 US$ millions	2003 US$ millions	2002 US$ millions
Fair value of plan assets	**132.5**	105.9	100.0	80.2	59.1
Present value of fund obligations	**161.7**	138.1	134.4	94.1	78.1
Deficit in the plan	**29.2**	32.2	34.4	13.9	19.0
Experience gains on plan assets	**3.5**	10.4	11.0	12.8	13.6
Experience gains / (losses) on plan liabilities	**0.3**	5.0	(3.0)	(0.4)	0.6

10. DEPOSITS

Deposits from customers include deposits from central banks.

The geographical composition of total deposits was as follows:-

	31.12.06 US$ millions	31.12.05 US$ millions
GCC countries	**11,484.3**	9,884.9
Other countries	**5,383.4**	3,577.6
	16,867.7	13,462.5

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

11. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the available-for-sale and trading security portfolios. At 31st December 2006, the fair value of available-for-sale and trading securities that had been pledged as collateral under repurchase agreements was US$2,128.2 million and US$161.1 million respectively (2005: US$3,395.1 million and US$359.6 million respectively).

12. OTHER LIABILITIES

	31.12.06 US$ millions	31.12.05 US$ millions
Accrued interest	**224.9**	209.3
Derivative financial instruments	**79.7**	123.8
Deferred items	**70.4**	70.9
Outstanding security settlements	**62.0**	28.3
Minority interests	**25.2**	84.4
Pension plan liability	**7.3**	1.5
Other, including accounts payable and accrued expenses	**94.0**	78.1
	563.5	596.3

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 27(d).

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

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

13. SENIOR TERM FINANCING

	Maturity	31.12.06 US$ millions	31.12.05 US$ millions
Floating rate note	2007	**350.0**	350.0
Islamic murabaha term facilities	2007	**57.4**	57.4
Islamic murabaha term facilities	2008	**6.1**	6.1
Floating rate repo	2007-2009	**500.0**	500.0
Floating rate loan	2009	**50.0**	50.0
Islamic murabaha term facilities	2009	**29.0**	29.0
Floating rate loan	2010	**800.0**	800.0
Islamic murabaha term facilities	2010	**14.6**	14.6
Floating rate loan	2011	**60.0**	-
Floating rate loans	2006	**-**	55.0
Islamic murabaha term facilities	2006	**-**	82.4
		1,867.1	1,944.5

14. SUBORDINATED TERM FINANCING

	31.12.06 US$ millions	31.12.05 US$ millions
Floating rate note due in 2015	**400.0**	400.0
Floating rate loans due in 2016	**150.0**	-
Floating rate loans due in 2011	**-**	150.0
	550.0	550.0

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

15. SHARE CAPITAL

The authorised share capital at 31st December 2006 comprised 3.0 billion shares of US$1 each (2005: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2006 comprised 1.0 billion shares of US$1 each (2005: 1.0 billion shares of US$1 each). All issued shares are fully paid.

16. RESERVES

	Compulsory reserve US$ millions	Voluntary reserve US$ millions	Cash flow hedge reserve US$ millions	Available-for-sale securities revaluation reserve US$ millions	Total US$ millions
At 1st January 2005	**125.2**	**62.7**	**4.4**	**97.5**	**289.8**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	-	15.0	15.0
- Cash flow hedges:					
net fair value losses	-	-	(3.0)	-	(3.0)
Transfers in the year:-					
- Transfers to net income	-	-	(3.2)	(5.0)	(8.2)
Net (losses) / gains recognised directly in equity	-	-	(6.2)	10.0	3.8
Transfers from retained earnings	20.5	20.5	-	-	41.0
At 31st December 2005	**145.7**	**83.2**	**(1.8)**	**107.5**	**334.6**
Arising in the year:-					
- Available-for-sale securities:					
net fair value gains	-	-	-	0.7	0.7
- Cash flow hedges:					
net fair value losses	-	-	(2.0)	-	(2.0)
Transfers in the year:-					
- Transfers to net income	-	-	2.6	(17.0)	(14.4)
Net gains / (losses) recognised directly in equity	-	-	0.6	(16.3)	(15.7)
Transfers from retained earnings	23.5	23.5	-	-	47.0
At 31st December 2006	**169.2**	**106.7**	**(1.2)**	**91.2**	**365.9**

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

17. DIVIDENDS

Dividends are not accounted for until they have been ratified at the general assembly. The dividend ratified in respect of 2006 will be accounted for in equity as an appropriation of retained earnings in the year ending 31st December 2007.

18. NET INTEREST INCOME

	2006 US$ millions	2005 US$ millions
Interest income		
Placements and other liquid assets	**283.2**	162.8
Due from brokers	**36.5**	19.3
Available-for-sale securities	**441.6**	315.1
Loans and advances	**474.5**	253.6
Total interest income	**1,235.8**	750.8
Interest expense		
Deposits from banks and customers	**722.8**	360.4
Securities sold under agreements to repurchase	**120.6**	98.4
Term financing	**134.7**	83.0
Total interest expense	**978.1**	541.8
Net interest income	**257.7**	209.0

Interest income on available-for-sale securities includes dividends from structured finance investments, the underlying investments of which are high quality, investment-grade rated debt securities.

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

19. FEE AND COMMISSION INCOME

	2006 US$ millions	2005 US$ millions
Fee and commission income		
Investment banking and management fees	**44.2**	31.0
Commissions on letters of credit and guarantee	**15.7**	12.0
Loan commitment fees	**4.4**	3.2
Other fee and commission income	**3.7**	2.0
Total fee and commission income	**68.0**	48.2
Fee and commission expense	**(2.2)**	(2.0)
Net fee and commission income	**65.8**	46.2

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, IPOs, and mergers and acquisitions.

Fee and commission expense principally comprises security custody fees.

20. TRADING INCOME

	2006 **US$ millions**	2005 US$ millions
Foreign exchange	**8.3**	9.1
Debt securities	**25.4**	13.4
Equity securities	**2.8**	-
Interest rate derivatives	**0.3**	2.0
Managed funds	**11.0**	18.4
Loans held for trading	**0.4**	0.7
	48.2	43.6

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.

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

Equity securities includes equities, equity convertibles, and contracts for differences.

Interest rate derivatives includes interest rate swaps, forward rate agreements, interest rate options, interest rate futures, and credit derivatives.

21. OTHER INCOME

Other income principally comprises dividends on available-for-sale equity investments, and loan recoveries.

22. SEGMENTAL INFORMATION

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

a) Business Segments

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

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

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

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

22. SEGMENTAL INFORMATION (continued)

The business segment analysis is as follows:-

	Merchant Banking US$ millions	Treasury US$ millions	Financial Markets US$ millions	Corporate and other US$ millions	Total US$ millions
2006					
Total income	**142.6**	**146.6**	**60.0**	**58.6**	**407.8**
Segment result	**126.0**	**134.9**	**42.3**	**57.5**	**360.7**
Unallocated overhead					**(96.9)**
Taxation charge on overseas activities					**(8.3)**
Net income after tax					**255.5**
Segment assets	**8,333.6**	**13,530.8**	**2,855.3**	**67.5**	**24,787.2**
Segment liabilities	**15.7**	**20,777.6**	**117.0**	**2,020.3**	**22,930.6**
Total equity					**1,856.6**
Total liabilities and equity					**24,787.2**
2005					
Total income	124.7	138.5	36.1	46.7	346.0
Segment result	109.5	127.8	21.0	45.6	303.9
Unallocated overhead					(96.6)
Taxation charge on overseas activities					(4.3)
Net income after tax					203.0
Segment assets	6,428.5	13,590.5	2,782.4	55.2	22,856.6
Segment liabilities	6.6	18,907.7	143.6	2,080.4	21,138.3
Total equity					1,718.3
Total liabilities and equity					22,856.6

b) Geographical segments

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

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

	2006 US$ millions	2005 US$ millions
GCC countries	**294.1**	255.5
Other countries	**113.7**	90.5
	407.8	346.0

The geographical analyses of deposits and risk assets are set out in notes 10 and 24 respectively.

23. RISK MANAGEMENT

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

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

Credit risk

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

The geographical distribution of risk assets is set out in note 24. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 27 while the notional and risk-weighted exposures for credit-related financial instruments are detailed in note 28.

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.

- **Trading market risk:** The Group's trading activities principally comprise trading in debt and equity securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and commodity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. It is recognised that there are

23. RISK MANAGEMENT (continued)

Market risk (continued)

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 5. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 27.

The VaR by risk class for the Group's trading positions, as calculated in accordance with the basis set out in note 30, was as follows:-

	2006				2005			
	31.12.06 US$ millions	**Average US$ millions**	**High US$ millions**	**Low US$ millions**	31.12.05 US$ millions	Average US$ millions	High US$ millions	Low US$ millions
Interest rate risk	**6.7**	**4.7**	**7.1**	**3.6**	4.6	4.5	5.8	2.7
Foreign exchange risk	**0.9**	**1.4**	**2.2**	**0.5**	1.3	1.2	2.0	1.0
Equity risk	**5.4**	**4.4**	**5.6**	**2.9**	2.8	2.9	3.9	2.3
Total diversified risk	**9.9**	**7.3**	**9.9**	**5.6**	6.4	6.3	7.5	5.0

- **Non-trading market risk:** Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities is set out in note 26. The Group does not maintain material non-trading foreign currency open positions. In general, the Group's policy is to match assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in note 27(e).

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

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

23. RISK MANAGEMENT (continued)

Liquidity risk

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

An analysis of available-for-sale securities by rating classification is set out in note 6 (a). The maturity profile of assets and liabilities is set out in note 25.

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.

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.

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 per cent compared to a minimum ratio of 8 per cent prescribed by the Basel Committee on Banking Supervision. Under the CBB's guidelines, GCC governments and GCC government-owned companies are accorded preferential risk-weightings of 0 per cent and 20 per cent respectively. 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 to determine the risk-weighted amounts for credit risk and specific market risk.

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 available-for-sale securities and derivative cash flow hedging transactions with the exception of unrealised losses arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale.
- Tier 2 capital, comprising qualifying subordinated term finance, collective impairment provisions and 45 per cent of unrealised gains arising on the remeasurement to fair value of marketable equity securities classified as available-for-sale.

The CBB applies various limits to elements of the 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 also are restrictions on the amount of collective impairment provisions that may be included as part of tier 2 capital. Collective impairment provisions cannot exceed 1.25 per cent of total risk-weighted assets.

23. RISK MANAGEMENT (continued)

Capital management (continued)

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, subordinated term finance, and innovative tier 1 capital securities.

The Group and its individually regulated operations have complied with all externally imposed capital requirements throughout the years ended 31st December 2006 and 31st December 2005.

There have been no material changes in the Group's management of capital during the years ended 31st December 2006 and 31st December 2005.

24. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.06					31.12.05
	Placements, due from brokers & 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	**728.1**	**1,497.3**	**7,468.4**	**3,358.3**	**13,052.1**	9,921.7
Other Middle East & North Africa	**55.5**	**73.9**	**303.5**	**127.3**	**560.2**	554.2
Europe	**3,764.8**	**3,387.6**	**355.7**	**243.0**	**7,751.1**	7,803.5
North America	**762.1**	**5,066.2**	**3.8**	**355.9**	**6,188.0**	6,205.7
Asia	**231.1**	**320.7**	**13.6**	**-**	**565.4**	744.8
Latin America	**-**	**263.3**	**-**	**10.0**	**273.3**	207.8
	5,541.6	**10,609.0**	**8,145.0**	**4,094.5**	**28,390.1**	25,437.7

An analysis of derivative and foreign exchange instruments is set out in note 27.

25. MATURITIES OF ASSETS AND LIABILITIES

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

	Within 3 months US$ millions	4 months to 1 year US$ millions	Years 2 and 3 US$ millions	Years 4 and 5 US$ millions	Over 5 years and other US$ millions	Total US$ millions
At 31st December 2006						
Cash and other liquid assets	153.2	115.0	-	-	-	268.2
Due from brokers	950.9	-	-	-	-	950.9
Placements with banks	4,305.2	17.3	-	-	-	4,322.5
Trading securities	2,186.1	-	-	-	-	2,186.1
Available-for-sale securities	126.0	389.8	1,093.3	1,780.8	5,033.0	8,422.9
Loans and advances	1,778.1	1,788.5	1,836.4	923.6	1,818.4	8,145.0
Other assets	379.8	56.2	1.2	2.0	52.4	491.6
Total assets	9,879.3	2,366.8	2,930.9	2,706.4	6,903.8	24,787.2
Deposits	15,554.5	1,313.2	-	-	-	16,867.7
Securities sold under agreements to repurchase	1,749.6	470.0	-	-	-	2,219.6
Securities sold but not yet purchased	862.7	-	-	-	-	862.7
Other liabilities	444.7	16.5	6.5	10.5	85.3	563.5
Term financing	44.0	363.3	585.1	874.7	550.0	2,417.1
Equity	-	-	-	-	1,856.6	1,856.6
Total liabilities & equity	18,655.5	2,163.0	591.6	885.2	2,491.9	24,787.2
At 31st December 2005						
Total assets	10,318.8	1,624.3	2,534.0	2,480.8	5,898.7	22,856.6
Total liabilities & equity	16,812.3	1,713.8	876.7	1,013.8	2,440.0	22,856.6

The asset and liability maturities are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Total average deposits throughout 2006 for counterparties with deposits of US$10.0 million and above at 31st December 2006 amounted to US$13,542.0 million (2005: US$10,740.9 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

26. INTEREST RATE RISK

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

	Within 3 months US$ millions	Months 4 to 6 US$ millions	Months 7 to 12 US$ millions	Over 1 year US$ millions	Non-interest bearing items US$ millions	Total US$ millions	*Effective interest rates %*
At 31st December 2006							
Cash and other liquid assets	**153.2**	**55.0**	**60.0**	-	-	**268.2**	*4.25*
Due from brokers	**950.9**	-	-	-	-	**950.9**	*4.15*
Placements with banks	**3,780.2**	**117.3**	**300.0**	**125.0**	-	**4,322.5**	*5.35*
Trading securities	**1,726.3**	-	-	-	**459.8**	**2,186.1**	*5.26*
Available-for-sale securities:-							
- Fixed rate	**31.4**	**28.1**	-	**303.8**	-	**363.3**	*5.42*
- Floating rate	**6,548.3**	**672.5**	**32.9**	-	-	**7,253.7**	*5.83*
- Equities & equity funds	-	-	-	-	**805.9**	**805.9**	-
Loans and advances	**6,095.0**	**1,910.4**	**177.4**	**7.7**	**(45.5)**	**8,145.0**	*6.45*
Other assets	-	-	-	-	**491.6**	**491.6**	-
Total assets	**19,285.3**	**2,783.3**	**570.3**	**436.5**	**1,711.8**	**24,787.2**	
Deposits	**16,102.3**	**556.0**	**209.4**	-	-	**16,867.7**	*5.06*
Securities sold under agreements to repurchase	**1,929.6**	**290.0**	-	-	-	**2,219.6**	*4.82*
Securities sold but not yet purchased	**862.7**	-	-	-	-	**862.7**	*4.84*
Other liabilities	-	-	-	-	**563.5**	**563.5**	-
Term financing	**2,357.1**	**60.0**	-	-	-	**2,417.1**	*5.75*
Equity	-	-	-	-	**1,856.6**	**1,856.6**	-
Total liabilities & equity	**21,251.7**	**906.0**	**209.4**	-	**2,420.1**	**24,787.2**	
Interest rate sensitivity gap	**(1,966.4)**	**1,877.3**	**360.9**	**436.5**	**(708.3)**	-	
Cumulative interest rate sensitivity gap	**(1,966.4)**	**(89.1)**	**271.8**	**708.3**	-	-	
At 31st December 2005							
Cumulative interest rate sensitivity gap	(2,153.1)	170.8	464.3	923.5	-	-	

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

The substantial majority of assets and liabilities reprice within one year. Accordingly there is limited exposure to interest rate risk. The principal interest rate risk beyond one year, as set out in the asset and liability repricing profile, represents the investment of the Group's net free capital in fixed rate government securities and fixed receive interest rate swaps. At 31st December 2006 the modified duration of these fixed rate securities and interest rate swaps was 5.95. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate securities and interest rate swaps was US$257,000.

26. INTEREST RATE RISK (continued)

Based on the repricing profile at 31st December 2006, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent increase in interest rates across all maturities would result in a reduction in net income before tax for the following year and in the Group's equity by approximately US$8.4 million and US$11.2 million respectively (2005: US$6.6 million and US$8.3 million respectively). The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

The Value-at-Risk by risk class for the Group's trading positions is set out in note 23. The market risk relating to foreign exchange and derivative trading instruments is set out in note 27.

27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS

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

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

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

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

The Group's principal interest rate-related derivative transactions are interest rate swaps, forward rate agreements, futures and options. An interest rate swap is an agreement between two parties to exchange fixed rate and floating rate interest by means of periodic payments based upon a notional principal amount and the interest rates defined in the contract. Certain agreements combine interest rate and foreign currency swap transactions, which may or may not include the exchange of principal amounts. In a forward rate agreement, two parties agree a future settlement of the difference between an agreed rate and a future interest rate, applied to a notional principal amount for an agreed period. The settlement, which generally occurs at the start of the contract period, is the discounted present value of the payment that would otherwise be made at the end of that period. An interest rate future is an exchange traded contract for the delivery of a standardised amount of a fixed income security or time

27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

deposit at a future specified date. Interest rate options, including caps, floors and collars, provide the buyer with the right, but not the obligation, either to purchase or sell an interest rate financial instrument at a specified price or rate on or before a specified future date.

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

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

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

a) Product analysis

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

	Notional amounts			Credit risk
	Trading US$ millions	Hedging US$ millions	Total US$ millions	amounts US$ millions
At 31st December 2006				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	2,272.2	2,940.2	5,212.4	19.7
Options purchased	169.4	-	169.4	5.0
Options written	169.4	-	169.4	-
	2,611.0	2,940.2	5,551.2	24.7
Interest rate contracts:-				
Futures	3,893.5	-	3,893.5	-
Interest rate swaps and swaptions	2,119.2	5,130.8	7,250.0	40.1
Options, caps and floors purchased	3,783.1	13.2	3,796.3	1.1
Options, caps and floors written	5,109.2	13.2	5,122.4	-
	14,905.0	5,157.2	20,062.2	41.2
Equity contracts:-				
Contracts for differences	1.7	-	1.7	0.2
Credit contracts:-				
Protection bought	391.1	-	391.1	1.4
Total	17,908.8	8,097.4	26,006.2	67.5
At 31st December 2005				
Total	12,766.2	9,112.8	21,879.0	49.8

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

27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

a) Product analysis (continued)

At 31st December 2006 the Value-at-Risk of the foreign exchange, interest rate, equity, credit derivative trading contracts analysed in the table on the previous page, as calculated in accordance with the basis set out in note 30, was US$0.5 million, US$0.5 million, nil and US$0.6 million respectively (2005: nil, US$0.7 million, nil and US$1.2 million respectively). Value-at-Risk is a measure of market risk exposure and is accordingly separate and in addition to the credit risk exposure represented by the credit risk amounts in the table on the previous page.

b) Counterparty analysis

		31.12.06		31.12.05
Credit risk amounts	**Banks**	**Other**	**Total**	Total
	US$ millions	**US$ millions**	**US$ millions**	US$ millions
OECD countries	**43.9**	**-**	**43.9**	39.9
GCC countries	**1.4**	**20.8**	**22.2**	9.8
Other countries	**0.1**	**1.3**	**1.4**	0.1
	45.4	**22.1**	**67.5**	49.8

Credit risk is concentrated on major OECD-based banks.

c) Maturity analysis

	Year 1	**Years 2 & 3**	**Years 4 & 5**	**Over 5 years**	**Total**
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**
At 31st December 2006					
Foreign exchange contracts	**5,547.6**	**3.6**	**-**	**-**	**5,551.2**
Interest rate contracts	**14,292.9**	**2,678.0**	**1,291.0**	**1,800.3**	**20,062.2**
Equity contracts	**-**	**-**	**-**	**1.7**	**1.7**
Credit contracts	**80.4**	**96.5**	**34.8**	**179.4**	**391.1**
Total	**19,920.9**	**2,778.1**	**1,325.8**	**1,981.4**	**26,006.2**
At 31st December 2005					
Total	17,404.4	1,430.6	1,351.2	1,692.8	21,879.0

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

27. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

d) Fair value analysis

	31.12.06		31.12.05	
	Positive fair value US$ millions	**Negative fair value US$ millions**	Positive fair value US$ millions	Negative fair value US$ millions
Derivatives held for trading:-				
Forward foreign exchange contracts	**0.6**	**(0.5)**	5.1	(2.7)
Foreign exchange options	**8.4**	**(8.5)**	5.8	(5.8)
Interest rate futures	**1.5**	**-**	0.7	-
Interest rate swaps and swaptions	**19.4**	**(16.4)**	13.7	(12.6)
Interest rate options, caps and floors	**-**	**-**	0.4	(0.5)
Equities - contracts for differences	**1.2**	**-**	2.1	(4.2)
Credit default swaps	**1.4**	**(2.0)**	0.4	(1.2)
	32.5	**(27.4)**	28.2	(27.0)
Derivatives held as fair value hedges:-				
Interest rate swaps	**10.0**	**(51.1)**	8.2	(93.0)
Derivatives held as cash flow hedges:-				
Interest rate swaps	**-**	**(1.2)**	-	(3.8)
Amount included in other assets/(other liabilities)	**42.5**	**(79.7)**	36.4	(123.8)

e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2006 or at 31st December 2005.

f) Hedge effectiveness

There were no ineffective portions of fair value or cash flow derivative hedging transactions recognised in the consolidated statement of income in either the year ended 31st December 2006 or the year ended 31st December 2005.

28. CREDIT-RELATED FINANCIAL INSTRUMENTS

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

	31.12.06		31.12.05	
	Notional principal amount US$ millions	**Risk-weighted exposure US$ millions**	Notional principal amount US$ millions	Risk-weighted exposure US$ millions
Direct credit substitutes	**398.7**	**350.6**	335.7	271.7
Transaction-related contingent items	**969.5**	**455.5**	838.2	388.2
Short-term self-liquidating trade-related contingent items	**409.2**	**75.5**	234.3	40.0
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**2,317.1**	**988.7**	1,541.4	681.2
	4,094.5	**1,870.3**	2,949.6	1,381.1

29. CONTINGENT LIABILITIES

Litigation

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

30. CAPITAL ADEQUACY

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

		31.12.06 US$ millions	31.12.05 US$ millions
Regulatory capital base			
Tier 1 capital:			
Total equity		**1,856.6**	1,718.3
Adjustment to exclude net fair value gains		**(90.0)**	(105.7)
Tier 1 capital		**1,766.6**	1,612.6
Tier 2 capital:			
Subordinated term financing		**550.0**	550.0
Non-specific loan provision		**60.0**	50.0
Tier 2 capital		**610.0**	600.0
Total regulatory capital base	*(a)*	**2,376.6**	2,212.6

Risk-weighted exposure

		Notional principal amount US$ millions	**Risk-weighted exposure US$ millions**	Notional principal amount US$ millions	Risk-weighted exposure US$ millions
Credit risk					
Balance sheet items:					
Cash and other liquid assets		**268.2**	**52.1**	345.4	68.2
Due from brokers		**950.9**	**-**	942.2	-
Placements		**4,322.5**	**900.1**	5,079.7	1,152.5
Securities		**10,609.0**	**7,618.7**	9,847.1	7,003.2
Loans and advances		**8,145.0**	**7,318.4**	6,273.7	5,907.5
Other assets		**491.6**	**319.8**	368.5	229.7
		24,787.2	**16,209.1**	22,856.6	14,361.1
Off-balance sheet items:					
Credit-related contingent items		**4,094.5**	**1,870.3**	2,949.6	1,381.1
Forward asset purchases		**214.7**	**42.9**	120.2	24.0
Foreign exchange-related items		**5,551.2**	**9.3**	4,040.5	13.3
Derivative-related items		**20,455.0**	**12.8**	17,838.5	11.5
		30,315.4	**1,935.3**	24,948.8	1,429.9
Credit risk-weighted exposure			**18,144.4**		15,791.0
Market risk					
General market risk			**491.5**		353.3
Specific market risk			**1,782.6**		1,332.4
Market risk-weighted exposure			**2,274.1**		1,685.7
Total risk-weighted exposure	*(b)*		**20,418.5**		17,476.7
Risk asset ratio [(a)/(b) x 100]			**11.6%**		12.7%

30. CAPITAL ADEQUACY (continued)

In accordance with the capital adequacy guidelines of the Bank's regulator, the Central Bank of Bahrain (CBB), revaluation gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions are excluded from tier 1 capital with the exception of losses arising on the remeasurement to fair value of marketable equity securities classified as available for sale. In accordance with the CBB's guidelines, gains arising on the remeasurement to fair value of marketable equity securities classified as available for sale are included in tier 2 capital. There were no fair value gains or losses in relation to marketable equity securities classified as available for sale at either 31st December 2006 or at 31st December 2005.

The Group calculates the capital requirement for general market risk using a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risks issued by the Basel Committee in January 1996. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the CBB. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at the regulatory minimum of 3.0 (2005: 3.0) by the CBB.

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

31. 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 2006 was US$21,689.5 million (2005: US$17,918.7 million).

32. RELATED PARTY TRANSACTIONS

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

The compensation of key management personnel was as follows:-

	2006 US$ millions	2005 US$ millions
Short term employee benefits	**10.2**	9.0
Post-employment benefits	**0.7**	0.6
	10.9	9.6

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

There were no other related party transactions.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, available-for-sale securities, securities sold but not yet purchased and derivative financial instruments. By contrast the fair value represents the amount at which an asset could be exchanged, or a liability settled, in a transaction between knowledgeable, willing parties in an arm's length transaction. Differences therefore can arise between book values under the historical cost method and fair value estimates. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation or to undertake a transaction on adverse terms. Generally accepted methods of determining fair value include reference to quoted market prices or to the pricing prevailing for similar financial instruments and the use of estimation techniques such as discounted cash flow analysis.

Based on the valuation methodologies outlined below, the fair values of all on- and off-balance sheet financial instruments were not significantly different to their net book values.

a) Securities

The fair values of securities are based on quoted market prices with the exception of investments in unquoted equity investments, the fair values of which are based on their book values.

b) Loans and advances

The fair values of loans held for trading are based on quoted market prices. The fair values of other loans on a floating interest rate basis are principally estimated at book value less provisions for impairment. The fair values of troubled sovereign debt are based on market bid prices. The fair values 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.

c) Term financing

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

d) Other on-balance sheet items

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

e) Credit-related contingent items

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

34. EARNINGS PER SHARE

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

	2006	2005
Net income after tax (US$ millions)	**255.5**	203.0
Weighted average number of shares in issue (millions)	**1,000.0**	1,000.0
Basic earnings per share	**US$0.26**	US$0.20

35. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

	Country of incorporation	**Ownership interest**	
		31.12.06	31.12.05
Gulf International Bank (UK) Limited	United Kingdom	**100%**	100%
GIB (UK) Capital Investments Limited	United Kingdom	**100%**	100%
SIB Financial Advisory Services Limited	United Kingdom	**100%**	100%
GIBINVEST E.C.	Bahrain	**100%**	100%

36. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

	At 31.12.06 US$ millions	At 31.12.05 US$ millions
Assets		
Cash and other liquid assets	**462.0**	189.1
Due from brokers	**1,080.2**	759.2
Placements with banks	**5,338.6**	4,588.4
Trading securities	**2,132.1**	1,751.8
Available-for-sale securities	**8,032.4**	7,906.0
Loans and advances	**7,585.7**	5,411.2
Other assets	**581.8**	423.7
Total assets	**25,212.8**	21,029.4
Liabilities		
Deposits from banks	**5,140.9**	4,664.4
Deposits from customers	**11,383.1**	7,707.9
Securities sold under agreements to repurchase	**2,844.2**	3,487.8
Securities sold but not yet purchased	**925.8**	691.7
Other liabilities	**729.7**	678.7
Senior term financing	**1,883.1**	1,918.0
Subordinated term financing	**546.2**	257.8
Total liabilities	**23,453.0**	19,406.3
Total equity	**1,759.8**	1,623.1
Total liabilities & equity	**25,212.8**	21,029.4

37. PARENT COMPANY

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

a) Condensed balance sheet

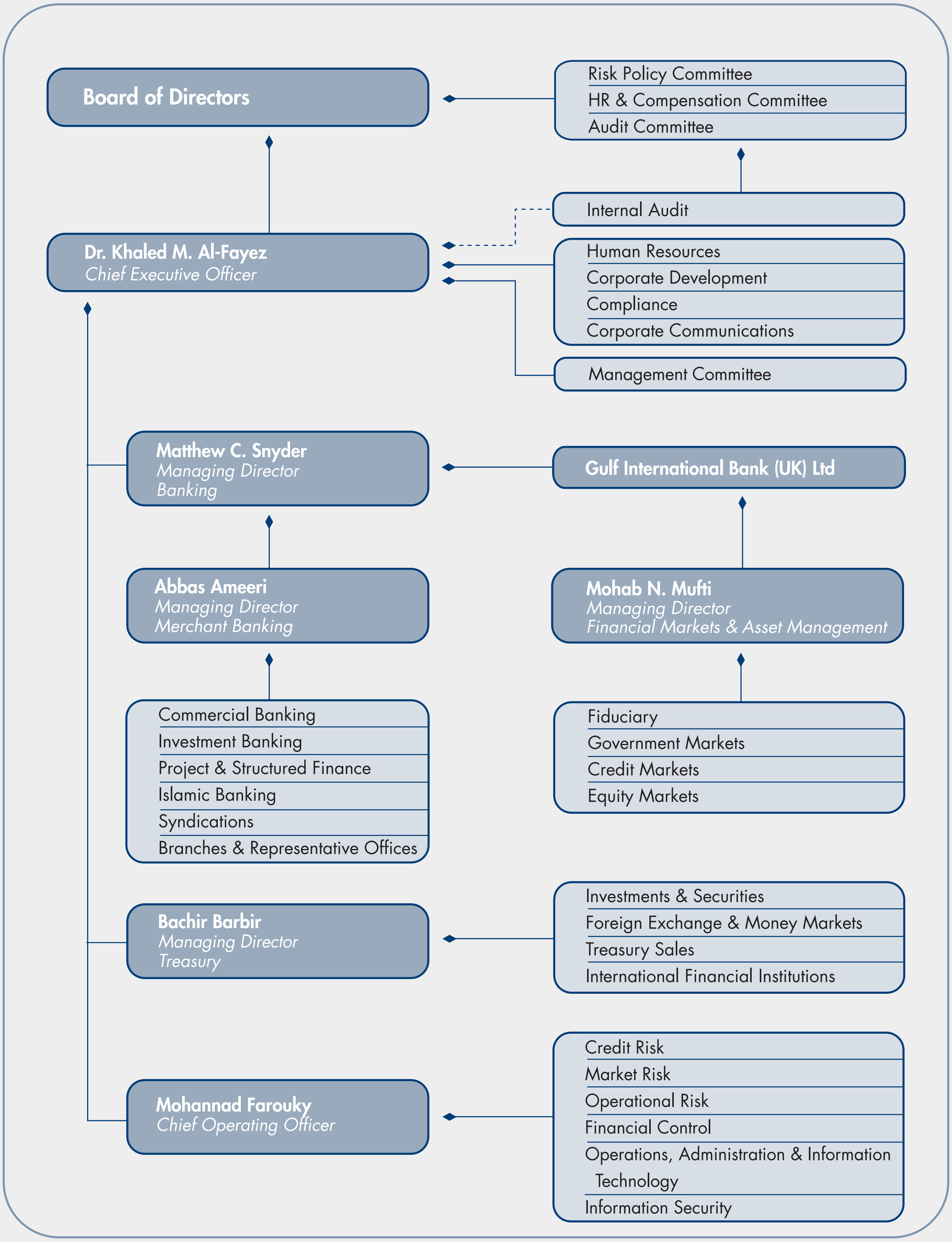
	At 31.12.06 US$ millions	At 31.12.05 US$ millions
Assets		
Cash and other liquid assets	**178.3**	286.4
Placements with banks	**2,445.3**	3,065.4
Trading securities	**377.1**	256.2
Available-for-sale securities	**8,402.4**	7,789.7
Investment in GIBUK	**346.6**	330.2
Loans and advances	**8,144.9**	6,233.9
Other assets	**397.2**	305.4
Total assets	**20,291.8**	18,267.2
Liabilities		
Deposits from banks	**5,611.4**	3,994.6
Deposits from customers	**7,928.1**	6,272.6
Securities sold under agreements to repurchase	**2,056.1**	3,352.5
Other liabilities	**422.3**	434.7
Senior term financing	**1,867.1**	1,944.5
Subordinated term financing	**550.0**	550.0
Total liabilities	**18,435.0**	16,548.9
Total equity	**1,856.8**	1,718.3
Total liabilities & equity	**20,291.8**	18,267.2

The investment in GIBUK is accounted for at fair value. Gains and losses arising from changes in the fair value of the investment are accounted for in equity.

b) Condensed income statement

	Year ended 31.12.06 US$ millions	Year ended 31.12.05 US$ millions
Net interest income	**235.3**	188.4
Provisions for securities	**-**	14.3
Provisions for loans and advances	**(0.8)**	(9.4)
Net interest income after provisions	**236.1**	183.5
Fee and commission income	**39.5**	25.5
Profits on available-for-sale securities	**28.7**	45.4
Trading income	**17.1**	25.3
Dividend received from GIBUK	**6.4**	13.3
Other income	**2.9**	2.4
Total income	**330.7**	295.4
Operating expenses	**86.8**	85.8
Net income before tax	**243.9**	209.6
Taxation charge on overseas activities	**8.3**	4.1
Net income after tax	**235.6**	205.5

ORGANISATION CHART



BOARD OF DIRECTORS

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

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

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

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

Mr. Saud Nassir Al-Shukaily ❶
Omani Citizen
BS in Business Administration, University of South Carolina, and MA in Development Management, American University, Washington, DC. Mr. Al-Shukaily was appointed to the Board in 1999. He is currently the Secretary General for Taxation at the Ministry of Finance, Sultanate of Oman. Earlier he served as Director General of Revenue and Investment at the Ministry of Finance (1996-2004), Director of the Minister's Office at the Ministry of Civil Services (1994-1996) and at the Ministry of National Economy (1996-1999). He is also a Member of the Board of Directors of Oman Flour Mills, Oman Cement Company and Petroleum Development of Oman.

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

Mr. Khalid Bin Abdulla Al-Suwaidi ❷
Qatari Citizen
BA in Accounting from South Eastern University, United Kingdom. He joined the Board in 2004. He is currently heads the Administration Department at the Qatar Investment Authority. Earlier, he was Director of Finance at Doha International Airport (1997-2003) and Office Director at the Deputy Secretary General's Office of the Supreme Council for Economic Affairs and Investment in Qatar from 2003-2006. In 2006 he was appointed as Office Manager to the Executive Board Member of Qatar Investment Authority.

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

Dr. Abdul Rahman Bin Ahmed Al-Jafary ❷ ❸
Saudi Arabian Citizen
Bachelor of Science in Geology, University of Washington, Seattle, USA, Master of Science in Educational Administration from East Texas State University, and a Ph.D. in Business Administration from the University of Oklahoma. He joined GIB's Board of Directors in 2005. Dr. Al-Jafary started his career as Administrative Assistant to the Dean of the College of Petroleum & Minerals in the Kingdom of Saudi Arabia, and worked as a teaching assistant at the University of Oklahoma. He joined King Fahd University of Petroleum and Minerals as Assistant Professor and Associate Professor (1979-1985). He also served as Dean of the College of Industrial Management between 1985-1989. Dr. Al-Jafary was appointed Secretary General of the Gulf Organisation for Industrial Consulting (1989-1999). He was selected as a member of the Saudi Arabian Shura Council in 1993 and held this post until 2005. During this period he served as Chairman of the Finance Committee for four years. He is a member in the Academy of Management and was a member of the Institute of Decision Sciences. Dr. Al-Jafary is a Board Member of the Saudi Arabian Mining Company and Dar Al Youm Press and Publishing. He has numerous published researches and lectures.

❶ Audit Committee Member
❷ HR & Compensation Committee Member
❸ Risk Policy Committee Member

SENIOR MANAGEMENT

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

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

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

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

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

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

General Management

Dr. Khaled Al-Fayez
Chief Executive Officer
Mohannad Farouky
Chief Operating Officer
Matthew Snyder
Managing Director - Banking
Bachir Barbir
Managing Director - Treasury
Abbas Ameeri
Managing Director - Merchant Banking
Mohab N. Mufti
Managing Director - Financial Markets & Asset Management

Merchant Banking

Commercial Banking
Ali Rahimi
Head of Bahrain, Kuwait and Saudi Arabia
Srinivas Vemparala
Head of Oman, Qatar & UAE
Asghar Ali Baba
Near East

Project & Structured Finance
M. Chandrasekaran
Head of Project & Structured Finance
Ravi Krishnan
Structuring & Project Advisory
Tarun Puri
Project Finance
Masood Tyabji
Islamic Banking
Rajan Malik
Syndications

GCC Capital Markets
Gary Griffiths
Head of GCC Capital Markets & Loan Agency

Investment Banking
Salman Al-Deghaither
Head of Investment Banking
Abdul Qaiyum
Corporate Finance - Abu Dhabi
Salman Chaudhry
Corporate Finance - Bahrain
Fakhre Fazli
Corporate Finance - Bahrain

Financial Markets & Asset Management

Asset Management Marketing
Saleem Taj
Head of Marketing & Business Development
Suzanne Ramadan
Marketing
Kay Turner
Fund Products

Equity Markets
Uday Patnaik
Head of Equity Markets
Paul Harrison
Equity Portfolio Management
Nigel Tyler
Equity Trading

Government Markets
Anthony Chisnall
Head of Government Markets
Charles Thomson
Bond Portfolio Management
Pierre Ahlsell De Toulza
Emerging Markets
John Benfield
G10 Markets

Credit Markets
Alex Veroude
Head of Credit Markets
Uli Gerhard
Corporate Debt - Investment Grade
Azhar Hussain
Corporate Debt - High Yield
Andrew Burgess
Asset Backed Securities

Private Equity
Gregga Baxter
Head of Private Equity

Treasury

Souheil Hajjar
Head of Investments
Adel Al-Dosseri
Head of Foreign Exchange & Money Markets, Bahrain
Adnan Al-Rifaie
Head of Riyadh Treasury
Steven Moulder
Head of London & New York Treasury
Salman Al-Zayani
Head of Treasury Sales
Ali Al-Qaseer
Head of International Financial Institutions
Austin Sequeira
Head of Treasury Policy & Administration

Risk Management

Masood Zafar
Chief Credit Officer
Stephen Williams
Group Financial Controller
Robert Amis
Chief Financial Officer - GIBUK
Jameel Al-Sairafi
Information Security - Bahrain
Shane Panjavani
Operational Risk - Bahrain

Support Functions

Hassan Abdul-Ghani
Head of Operations & Administration
Ali Buhejji
Operations - Bahrain
Ali Ashoor
Administration - Bahrain
P. K. Nambiar
Information Technology
Gordon Brooker
Operations & Administration - GIB UK
Rashed Abdul-Rahim
Operations & Administration - Riyadh Branch

Human Resources

Hassan Abdul-Ghani
Head of Human Resources
Jamal Hijris
Human Resources - Bahrain
Laura Ritchie
Head of Personnel - GIBUK

Audit, Legal & Compliance

Hassan Al-Mulla
Group Chief Auditor
Julian Anthony
Audit - London
Sally Wells
Company Secretary - GIBUK
Georges Djandji
Head of Compliance - Bahrain

Corporate Communications

Abdulla Naneesh
Head of Corporate Communications

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Faiz Al-Barwani
Secretary to the Board

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