GULF INTERNATIONAL BANK

# Annual Report 2008

GIB

بنك الخليج الدولي

THE GULF'S OWN MERCHANT BANK

# Contents

Gulf International Bank is a leading merchant bank in the Middle East with its principal focus on the Gulf Cooperation Council (GCC) states. 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.

The Bank was established in the Kingdom of Bahrain in 1975. It is owned by the six GCC governments and the Saudi Arabian Monetary Agency. 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
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THE GULF'S OWN MERCHANT BANK

# Financial Highlights

| | **2008** | 2007 | 2006 | 2005 | 2004 |
|---|---|---|---|---|---|
| **EARNINGS (US$ millions)** | | | | | |
| Net (loss) / income after tax | **(396.2)** | (757.3) | 255.5 | 203.0 | 150.2 |
| Net interest income | **288.3** | 305.6 | 257.7 | 209.0 | 175.2 |
| Fee and commission income | **73.3** | 88.1 | 65.8 | 46.2 | 36.7 |
| Operating expenses | **142.9** | 141.2 | 144.0 | 138.7 | 124.4 |
| **FINANCIAL POSITION (US$ millions)** | | | | | |
| Total assets | **25,033.5** | 29,954.0 | 24,787.2 | 22,856.6 | 19,239.0 |
| Loans | **12,972.1** | 12,601.8 | 8,145.0 | 6,273.7 | 4,847.1 |
| Investment securities | **2,220.5** | 8,070.7 | 8,422.9 | 7,839.6 | 8,469.1 |
| Senior term financing | **2,431.5** | 2,657.8 | 1,867.1 | 1,944.5 | 1,678.3 |
| Equity | **1,925.5** | 2,215.3 | 1,856.6 | 1,718.3 | 1,586.6 |
| **RATIOS (Per cent)** | | | | | |
| **Profitability** | | | | | |
| Return on average equity | **(19.1)** | (37.2) | 14.3 | 12.3 | 9.9 |
| Return on average assets | **(1.4)** | (2.8) | 1.1 | 1.0 | 0.8 |
| **Capital** | | | | | |
| Risk asset ratio* | | | | | |
| - Total | **17.3** | 12.0 | 11.6 | 12.7 | 11.0 |
| - Tier 1 | **12.5** | 9.5 | 8.7 | 9.2 | 9.7 |
| Equity as % of total assets | **7.7** | 7.4 | 7.5 | 7.5 | 8.2 |
| **Asset Quality** | | | | | |
| Loans as % of total assets | **51.8** | 42.1 | 32.9 | 27.4 | 25.2 |
| Securities as % of total assets | **9.7** | 31.4 | 42.8 | 43.1 | 52.4 |
| **Liquidity** | | | | | |
| Liquid assets ratio | **46.3** | 52.8 | 65.2 | 70.9 | 73.9 |
| Deposits to loans cover (times) ** | **1.6** | 1.8 | 2.3 | 2.5 | 2.6 |

* Risk asset ratio calculated under BIS Basel 1 for years ended prior to 2008. Basel 2 for 2008.

** Deposits include term financing.

## Credit Ratings

| | Fitch | Moody's | Standard & Poor's | Capital Intelligence |
|---|---|---|---|---|
| Long-term | A | A3 | BBB+ | A+ |
| Short-term | F-1 | P-2 | A-2 | A1 |
| Individual | C/D | | | |
| Financial Strength | | D+ | | A- |
| Outlook | Stable | Stable | Stable | Stable |

# *Our values*

A classic arabesque pattern, the inspiration for our Annual Report, takes us back to our roots. It is in these roots that GIB's four core values lie.

# Chairman's Statement

Jammaz bin Abdullah Al-Suhaimi
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 2008. Without doubt, this proved to be one of the most challenging years in the Group's history.

During the second half of 2008, the global credit crunch, sparked by the meltdown in the US sub-prime mortgage sector the previous year, intensified into a full-blown global financial crisis, which industry analysts have described as the worst for over 70 years. The contagion effect, which spread to almost every asset class, also impacted the GCC markets. Most of the regional stock markets witnessed their worst year ever; many major industrial projects were either put on hold or cancelled; and oil prices plummeted by over 70 per cent from their record high in July 2008. While the underlying fundamentals of the Gulf region remain strong, and economic stability is unlikely to be severely undermined by the weakening global economy, it will take considerable time before the markets begin to recover, and the outlook for 2009 remains challenging.

Accordingly, the Bank implemented a number of important initiatives during 2008, designed to strengthen its ability to meet current and future challenges, and protect the interests of all its stakeholders. The most important of these was the sale of a significant portion of its non-core investment securities portfolio, effective 31st December 2008. The securities were sold at their amortised cost less specific provisions for impairment as at the effective date of the sale. The securities comprised the Bank's entire exposure to collateralised debt obligations and other asset-backed securities, investments in financial institution subordinated debt, and certain financial institution senior debt. Following the sale, GIB had no exposure to collateralised debt obligations or other asset-backed securities. This transaction protects the Bank from any future losses from these securities, materially delevers and de-risks the balance sheet, reduces risk-weighted assets resulting in a significant enhancement of the Bank's regulatory capital adequacy ratios, and eliminates the funding risks of the assets.

This proactive and bold approach, which is now increasingly recognised as the most effective way of addressing the current lack of confidence in the global banking industry, illustrates the decisive approach to removing the distraction of the non-core investment securities portfolio. This will enable the Bank to focus on its core business activities, continue to strengthen its franchise, and further enhance its professional reputation in the marketplace.

Other steps taken in 2008 include the implementation of a strategy by the Bank's UK subsidiary, GIB(UK) Limited, focusing on client asset management and treasury services. In this context, GIBUK's proprietary trading activities were discontinued in the first quarter of the year thereby insulating the Bank from the severe market volatility witnessed in the latter part of the year.

GIB achieved a pre-provision operating profit of US$179.8 million for 2008, compared to US$201.2 million the previous year. After taking into account prudent and conservative provisions, the Bank reported a net loss of US$396.2 million, representing a substantial improvement over the net loss of US$757.3 million in 2007. In view of expectations of deteriorating economic and market conditions in 2009, GIB increased its non-specific provisions against its loan portfolio by a significant US$120 million in 2008 to ensure that it has a conservative buffer as it enters a potentially uncertain environment. The significantly higher provision level is based on the historically highest-ever corporate default rates, witnessed in 1991. However, I would like to stress that the Bank's loan portfolio, which recorded only a marginal increase in 2008 to US$12.9 billion (2007: US$12.6 billion) remains strong and healthy, with exposures primarily to regional governments and government-related entities, regional infrastructure projects, and project financings with strong supporting cash flows. GIB's capital adequacy levels improved significantly during the year, with Basel 2 Total and Tier 1 ratios at 31st December 2008 of 17.3 per cent and 12.5 per cent respectively, both exceptionally high in relation to international standards.

I am pleased to report that the Bank's core merchant banking activities generated yet another strong performance in 2008, with total revenues exceeding the previous year's record performance. This reflects a strong increase in interest income, and the success of GIB's relationship managers in continuing to utilise the Bank's relationships to generate non-asset based fee income. These achievements once again reinforce the validity of GIB's GCC-focused merchant banking strategy. Introduced six years ago, this has successfully contributed to the Bank's ongoing diversification and quality of earnings, and its enhanced international status and reputation.

Today, GIB is a market leader in a number of banking services in the region, including project and structured finance, syndications and corporate advisory. The Bank is also one of the largest Arab commercial managers of clients' assets, with a US$14 billion portfolio of fiduciary assets under management. The Bank's new financial services company in Saudi Arabia - GIB Financial Services - which commenced operations in 2008, underlines GIB's strategy of expanding its activities into key financial markets of the GCC.

Looking ahead, the Board and Management are currently evaluating ways of further strengthening the Bank's already successful GCC-based franchise to facilitate the earliest possible return to profitability. Proposals for a new strategy and business model for GIB are currently under review.

A number of changes took place in the composition of the Board during the year. On behalf of the Board of Directors, I would like to pay tribute to the outgoing

Chairman, Sheikh Ebrahim bin Khalifa Al Khalifa, who served GIB with distinction since 2001. I also welcome Mr. Khalil Nooruddin, who represents Bahrain Mumtalakat Holding Company, the sovereign wealth fund of the Kingdom of Bahrain, as a new Director of the Board. His skills and experience will greatly assist the Board in carrying out its duties.

With sadness, I announce the decision of the Bank's Chief Executive Officer, Dr. Khaled Al-Fayez, to retire after working for more than 35 years in the banking industry. Dr. Al-Fayez served as the Bank's first General Manager until 1983, when he joined Gulf Investment Corporation as Group Chief Executive Officer. He returned to GIB in 2001 as Chief Executive Officer. During his tenure, the Bank developed into a leading player in many fields: GIB was the first bank in the Middle East to have a senior debt issue and a subordinated debt issue and to be awarded investment-grade ratings by all three major international rating agencies. On behalf of the Bank's shareholders, directors, management and staff, I would like to thank Dr. Al-Fayez for his leadership and contribution to the development of GIB into a highly respected financial institution, and wish him a blessed and well-earned retirement.

In turn, I would like to welcome Dr. Yahya Alyahya as the new Chief Executive Officer, who assumed his new role on 1st January 2009. Dr. Alyahya brings with him a wealth of experience in both the public and private sectors, which will prove invaluable in leading GIB during these challenging times. As the new Chairman of GIB, I look forward to working with my fellow Directors and the Management team to guide the Bank's strategic direction, and ensure the continued future success of GIB as a leading regional financial institution, providing prosperity for our stakeholders.

Finally, on behalf of the Board of Directors, I express my sincere appreciation for the support and encouragement of our shareholders; for the continued loyalty and trust of our 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 regional regulatory and supervisory authorities.

Jammaz bin Abdullah Al-Suhaimi

*Chairman*

# *Reliability*

Expressed through the geometric pattern which has a distinct centre point that emphasises a singularity of purpose.

THE PERFORMANCE OF GIB'S CORE MERCHANT and investment banking activities during 2008 compared favourably with the record performance generated by the Bank in 2007. This reflected both an increase in interest income, and the growing ability of the Bank to leverage lending relationships to generate fee income. Significantly, this performance was achieved against the backdrop of a severe global financial crisis and economic downturn during 2008, and the adverse impact on the GCC region during the latter half of the year. Throughout the year, GIB continued to implement its GCC-focused merchant banking strategy which, since 2002, has successfully contributed to the quality and diversification of the Bank's sources of revenue.

## ECONOMIC AND MARKET BACKGROUND

Against the backdrop of the US sub-prime mortgage crisis, the year generally started on a positive note, with growth momentum across the GCC economies supported by strong business fundamentals and sustained investor confidence, despite some underlying concerns about inflation, liquidity, energy costs and the value of real estate assets. The GCC stock markets continued to perform well in the first half of 2008, building on the strong recovery that characterised the previous year.

However, by the second half of 2008, sub-prime related stresses in US financial markets transformed into a global financial crisis, causing severe market dislocations and seizing up credit markets. The intensity of this crisis seriously impacted developed and developing economies alike, while increased risk aversion led to widening spreads, falling equity markets, and a retrenchment in capital flows. Governments around the world were forced to intervene and bailout or nationalise many leading financial institutions, while tumbling demand resulted in diminished industrial production in both the East and the West.

In this climate, not only have growth prospects for both high-income and developing countries deteriorated substantially, but the ensuing impact on the GCC region has also proven to be far deeper and wider than anticipated. The price of crude oil plummeted from a record high of just under US$150 per barrel in July to less than US$40 by the end of the year, and deficit balances have emerged across numerous regional accounts as a result. Moreover, the difficult global financial market conditions have led to large losses in the region's vast overseas investment portfolios, while most of the GCC stock markets witnessed their worst year ever in 2008, slumping even more than the bourses in the West where the crisis began. GCC stock market capitalisation dropped to US$600 billion, compared to US$1.2 trillion at the end of 2007. Worsening conditions also prevented major international banks from continuing project financing activities in the GCC, with several of the region's large industrial projects being put on hold or cancelled, while many existing projects experienced difficulties in securing refinancing facilities.

In spite of circumstances remaining difficult, the medium-term outlook for the GCC economies remains cautiously optimistic, since regional countries have a comparatively stronger base from which to recover, given the accumulation of huge reserves of cash following the six-year economic boom that accompanied soaring oil prices. The underlying macro-economic fundamentals of the GCC economies remain strong, with the IMF and World Bank forecasting GDP growth to slow down marginally to between three and five per cent in 2009 compared to around six per cent in 2008. While fiscal budgets are being adjusted to either balance or show deficit balances for 2009, most GCC governments have committed funding to complete major social and infrastructure projects, while regional markets are expected to react positively once global conditions start improving.

## MERCHANT BANKING

With activity in the syndicated loan and project finance markets coming to a virtual standstill for new business during the latter half of 2008, GIB focused on closing loan mandates on hand, providing support to its bilateral relationships, and diversifying revenue streams. As a result, the loan portfolio recorded moderate growth of around 5 per cent. Despite an increase in the average cost of funding resulting from the market illiquidity during the second half of the year, the gross revenue from loans and advances increased compared to 2007.

The regional syndicated loan market was severely disrupted during the second half of 2008, with volumes plummeting compared to the previous year due to a lack of liquidity. The situation was further exacerbated by international banks, which dominate the high end of the market, cutting down or ceasing their involvement in project financing deals in emerging markets, as the full impact of the credit crunch unfolded. This adversely impacted the volume of syndicated loans arranged and managed by the Bank in all sectors where it had successfully maintained dominant regional league table positions in earlier years, for the areas of corporate finance, project financing and financial institutions. Nevertheless, acting as a mandated lead arranger, the Bank was successful in executing several syndicated loan transactions under extraordinary market conditions. These included a SAR3.2 billion Sharia-compliant, contract-related facility for the Saudi Binladen Group, incorporating letters of credit and letters of guarantee issuance, to finance construction of a housing project for the King Abdullah University for Science & Technology; a US$375 million syndicated term loan facility for United Arab Shipping Company for the acquisition of container vessels; a US$100 million Islamic facility for BMI Bank (Bank Muscat International); a US$500 million project financing facility for Qatar Electricity and Water Company for its Ras Abu Fontas Power and Water Desalination Project; a US$100 million term facility for New Medical Centre in UAE for its health care business; and a US$1.8 billion commercial facility for Saudi Polymers Company's US$5 billion greenfield integrated petrochemical complex at Al-Jubail.

Increasing emphasis on fee-generating business led to securing mandates from regional borrowers for project development and debt advisory mandates during the year. The mandates include raising debt and equity for three greenfield projects in Saudi Arabia; arranging financing for a regional shipping company; assisting several developers during the bidding process for selection of partners for a number of independent power and water projects; and balance sheet restructuring for several other clients.

The Bank's GCC private equity business enjoyed an active and successful year in 2008, highlighted by a number of new acquisitions. GIB's portfolio comprises a total current investment of US$130 million, with a fair value of US$175 million. The pooled gross IRR of unrealised investments is 20 per cent, which compares more than favourably with many of the top-quartile PE funds worldwide. The Bank is a co-sponsor of the highly successful GCC Equity Fund, of which the fair value of the initial investment of US$20 million in 2006 is now estimated at US$50 million, representing an IRR of 41 per cent.

Capital market transactions in 2008 globally were affected by market volatility and reduced investor confidence, with many corporations delaying issuance until conditions improve. The GCC region was no exception, with regional Islamic Sukuk issuance which dominated capital markets during 2006 and 2007, dropping dramatically during 2008. GIB, in consultation with relevant issuers, placed on hold the launch of a number of Sukuk issues for which it had been mandated earlier in the year. However, in what constitutes a groundbreaking transaction, the Bank solely managed the sale of UAE Dirhams 600 million (US$163 million) of Sukuk for Qatar-based Al Mana Group, a major trading, automotive and contracting company, to fund its ongoing expansion plans. Comprising a unique, innovative Sharia-compliant structure, this was the first time that a Qatari company had raised financing in UAE Dirhams, paving the way for corporations in the region to tap cross-border opportunities and liquidity, in order to finance projects and expansion programmes.

GIB maintains a presence outside the GCC region through its branches in London and New York, and its representative offices in Abu Dhabi and Beirut. Based on significant trade flows and long-term relationships with the GCC, the Bank's international trade finance and institutional lending is mainly conducted in the MENA region. In 2008, GIB maintained its support for international contractors and sponsors involved in projects across the region, through the issuance of performance and project-related guarantees, letters of credit, and working capital facilities.

## INVESTMENT BANKING

After a positive start to the year, the region's investment banking sector was affected by adverse market conditions during the latter half of 2008, particularly following the dramatic fall in GCC stock markets after the Lehman Brothers bankruptcy in September. The global financial crisis affected investor sentiment, with many scheduled IPOs and private placements delayed or cancelled, and several planned mergers and acquisitions put on hold.

Through its Saudi-based subsidiary, GIB Financial Services (GIBFS), the Bank acted as exclusive financial adviser on two IPOs during the year. The first was for Halwani Brothers Company, which was oversubscribed more than nine times. The total issue size was SAR171.4 million, while subscriptions received from institutional and retail investors exceeded SAR1.6 billion. GIB also acted as joint book runner for the institutional tranche of the offering. The second was for Abdullah Al Othaim Markets Company, which was oversubscribed more than 10 times. The total issue size was SAR270 million, while subscriptions received from institutional and retail investors exceeded SAR2.75 billion. GIB also acted as lead underwriter for this offering.

The Bank was also involved in a number of private placements during 2008. These included acting as GCC financial adviser for British Islamic Insurance Holdings (BIIH) on its second round of equity raising; advising Dubai Investments Company (DI) on the sale of a 40 per cent equity stake in M'Sharie, the private equity arm of DI; and privately placing two million shares of Riyadh Cement Company.

Moreover, GIB acted as financial adviser to Suez

Environment, a leading global player in water and waste treatment, in the acquisition through one of its subsidiaries (Trashco) of Al Duwiyya General Transport, which specialises in solid waste disposal in Abu Dhabi. The Bank was also mandated by the High Commission for Development of Hail Region in Saudi Arabia to act as lead financial adviser, lead manager and underwriter for the Hail Cement Company (under incorporation), due to be established with a capital of SAR1.2 billion, half of which is planned to be offered to the public through an IPO on the Saudi Stock Exchange (Tadawul). In another key achievement, GIB obtained listing sponsor status at Dubai International Financial Exchange (DIFX), which will enable it to advise companies planning on listing on the DIFX.

## ASSET MANAGEMENT

In early 2008 the Bank's London-based subsidiary, Gulf International Bank (UK) Limited (GIBUK), embarked on a major initiative to concentrate resources and emphasis on its asset management business. This has enabled the Group to perform more effectively and competitively, despite a worsening global market environment.

Client assets under management (AuM) by GIBUK at year-end were US$14.3 billion. In 2008, when no liquid asset class, with the exception of government bonds, yielded a positive return and global equities lost 40 per cent of their value, client redemptions accounted for less than 2.5 per cent of AuM. GIBUK remains one of the largest and most established commercial asset managers in the Middle East.

The UK-based investment team manages a diversified range of international products covering a wide spectrum of asset classes. The business is divided across five main sub-groups: Bond Portfolios, investing in global sovereign bonds, including emerging markets; Equity Portfolios, investing in and providing coverage of global and regional equity markets and convertible securities; Fund Products, delivering specialised exposure to investment grade and high yield corporate fixed income assets; Structured Products, managing vehicles covering the whole spectrum of asset-backed securities; and Treasury Services, exercising fiduciary duty in placing clients' cash across a range of maturities. These activities are supplemented by a dedicated client function providing the highest quality service to all investors.

The business optimisation initiatives taken at the start of 2008 have ensured that the Bank's asset management team is well positioned to drive growth in assets and fees, even as competitors are consolidating. Key objectives for 2009 include maintaining the current coverage of global assets with a drive towards a stronger emerging markets specialisation, together with an increased focus on improving client service to enhance customer loyalty and brand presence, both in the Middle East and globally.

## TREASURY

GIB's Treasury business faced extremely challenging conditions during 2008, with global and regional liquidity rapidly deteriorating, particularly during the latter half of the year. With credit markets remaining virtually locked during the last quarter, and banks increasingly reluctant to lend to each other, GIB moved quickly to tackle funding challenges on a proactive basis. Due to long-standing relationships nurtured with the Bank's key depositors, it proved possible to adequately meet funding requirements. In addition, the liquidity situation of the Bank was significantly safeguarded by measures taken in recent years to diversify sources of funding.

Client business in foreign exchange remained strong during 2008, and GIB continued to see a growing demand for products to hedge interest rate and currency risks, particularly as a result of the high levels of market volatility. Of particular importance, GIB's foreign exchange earnings of US$16.1 million in 2008 were at their highest ever level. This entirely reflected income generated from customer-related business.

On the assets side, as part of the Bank's strategic initiatives to de-risk the balance sheet and refocus on its core business activities, a significant portion of the non-core investment securities portfolio was disposed of in a sale effective 31st December 2008. The assets sold included the Bank's entire exposure to collateralised debt obligations, asset-backed securities and subordinated bank debt, on which GIB had taken substantial provisions for impairment. As a result of the sale, the Bank has successfully de-risked its balance sheet and significantly enhanced its regulatory capital adequacy ratios.

For 2009, GIB's strategy will be increasingly focused on well-diversified investment management as well as client-oriented business activities. The Bank will use its specialist financial market skills and expertise to structure appropriate risk management solutions for its clients.

GIB's capital adequacy levels remain strong, with Basel 2 Total and Tier 1 ratios of 17.3 per cent and 12.5 per cent both high in relation to global standards. The international rating agencies have indicated that GIB follows a conservative provisioning approach and enjoys very strong support from its shareholders.

# *Creativity*

In spite of the strictures imposed by traditional patterns, there is infinite variety through duplication, combination and interlacing of shapes to create intricate patterns.

OPERATING INCOME WAS US$179.8 MILLION for the year. This was 11 per cent lower than in the previous year despite the unprecedented market turmoil and deteriorating global economic environment witnessed during the year. Total income of US$322.7 million was 6 per cent down on 2007 while total expenses were at much the same level as in the prior year. Net interest income of US$288.3 million was 6 per cent lower than in the prior year largely reflecting reduced investment security volumes resulting from ongoing maturities. Fee and commission income at US$73.3 million was 17 per cent down on the prior year. This was nevertheless the second highest level of fee income in the Bank's history, reflecting fees derived from a diversified range of business activities including asset and fund management, letters of credit and guarantees, and corporate advisory. In keeping with GIB's traditional conservative approach to provisioning, the Bank made a significant addition to its non-specific loan provision in 2008. In view of the prevailing economic conditions, the Bank increased its non-specific loan provision to a level consistent with probabilities of default equating to the previous highest ever corporate default levels that were witnessed in 1991. As a result, the non-specific loan provision was increased by US$115.0 million to US$180.0 million at the end of 2008. This high provisioning level will provide a conservative buffer as the Bank could face a challenging environment in 2009. After taking account of the exceptional loan loss provision charge, and provisions for investment securities that were subsequently sold, the Bank recorded a net loss of US$396.2 million. This was a marked improvement over the net loss of US$757.3 million recorded in 2007.

## NET INTEREST INCOME

Net interest income at US$288.3 million was US$17.3 million or 6 per cent lower than in the prior year. Net interest income is principally derived from the following sources:-

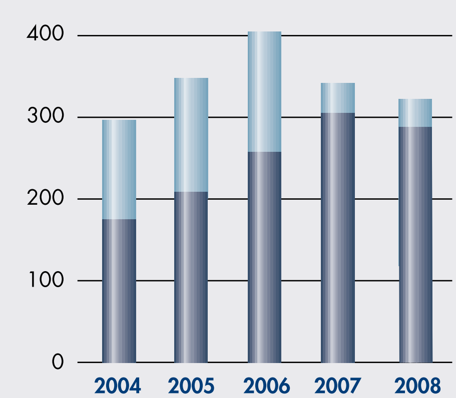
- margin income on the commercial lending portfolio,
- margin income on the investment securities portfolio,
- money book activities, and
- earnings on the investment of the Group's net free capital.

The year-on-year decrease in net interest income was largely attributable to lower interest earnings on the investment of the net free capital attributable to the significant reduction in US interest rates to historically low levels, and also to lower net interest earnings derived from the investment securities portfolio as a result of the non-replacement of maturing securities. These decreases were, however, largely offset by higher net interest earnings derived from the Group's commercial lending portfolio. Loan margin income was 38 per cent up on the previous year. This reflected both higher average volumes and average margins. While there was only a relatively small year end to year end increase in the loan portfolio, there was a more significant year-on-year increase in the average loan volume. The more restrictive credit environment also facilitated the enhancement of margins on both new and renewed credit facilities. Net interest earnings on the commercial lending portfolio accounted for more than half of the Group's net interest income in 2008.

Margin income on the investment securities portfolio accounted for 17 per cent of net interest income in 2008. Margin income on investment securities decreased by 6 per cent in 2008 as maturing assets were not replaced due to the credit market turmoil prevailing during most of the year.

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

**Gross income development (US$ millions)**




| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Non interest income | 121.4 | 139.2 | 147.7 | 36.8 | 34.4 |
| Net interest income | 175.2 | 209.0 | 257.7 | 305.6 | 288.3 |
| Gross income before provisions | 296.6 | 348.2 | 405.4 | 342.4 | 322.7 |

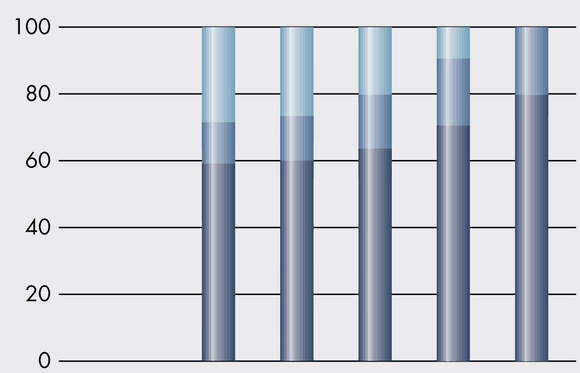
the mismatch of the repricing profile of the Group's interest-bearing assets and liabilities. Money book earnings in 2008 were lower than in the prior year reflecting a higher cost of funds during the second half of the year. The money book nevertheless generated positive interest earnings for the year. Due to the reliance on deposits derived from counterparties in the GCC and wider Middle East, the increase in costs in the international interbank markets associated with the credit market crisis had a relatively limited impact on the Bank's interest earnings.

Earnings on the investment of the Group's net free capital were 36 per cent down on the prior year. The net free capital was largely uninvested during the year with the uninvested funds placed on a short term basis in the money market. Earnings on the net free capital were therefore negatively impacted by the significant reduction in short term US interest rates during the latter part of the year to historically low levels.

### NON-INTEREST INCOME

Non-interest income comprises fee and commission income, trading income, realised profits on investment securities and other income.

**Gross income composition (%)**

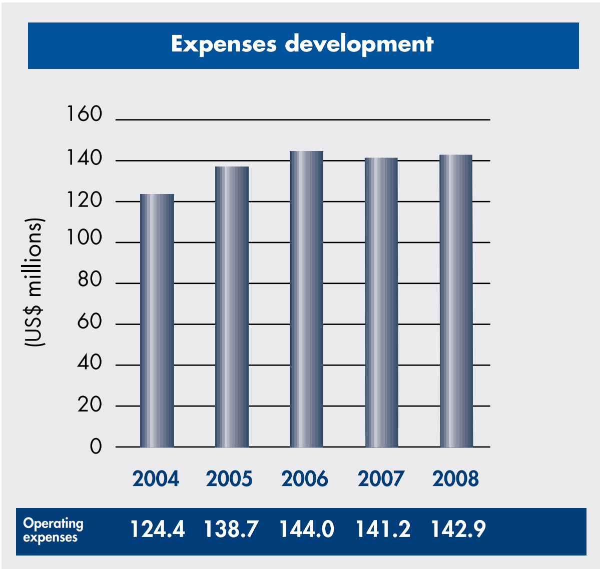



| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Trading and other income* | 28.5 | 26.7 | 20.2 | 9.1 | - |
| Fee and commission income | 12.4 | 13.3 | 16.2 | 20.3 | 20.3 |
| Net interest income | 59.1 | 60.0 | 63.6 | 70.6 | 79.7 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

* *To facilitate year-on-year comparison, 2008 and 2007 trading income excludes losses on exposures directly impacted by the credit market crisis.*

Fee and commission income, which at US$73.3 million represented the second largest income category, was at the second highest level in the Bank's history. Fee and commission income was US$14.8 million or 17 per cent lower than the record level of fee income recorded in 2007. Fee and commission income has nevertheless grown almost threefold in the six 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 22 to the consolidated financial statements. Investment banking and management fees at US$48.1 million were US$13.1 million or 21 per cent down on the prior year. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory and underwriting activities. The year-on-year decrease reflected the generally lower level of investment banking activity in the stressed market environment. As referred to in note 34 to the consolidated financial statements, assets held in a fiduciary capacity amounted to US$14.3 billion at 31st December 2008. GIB therefore continues to be the largest Arab-owned commercial asset manager. Commissions on letters of credit and guarantee at US$22.8 million were US$2.0 million or 10 per cent up on the prior year and therefore continued to make an important contribution to fee and commission income. The significant year-on-year advance was largely attributable to an increase in guarantee commissions on GCC-related business activities.

The Group's various trading activities incurred a US$86.7 million loss for the year. Trading income is reported inclusive of all related income, including interest income, gains and losses arising on the purchase and sale, and from changes in the fair value of trading securities, dividend income, and interest expense, including all related funding costs. An analysis of trading income is set out in note 23 to the consolidated financial statements. The trading loss for the year included a loss of US$28.4 million arising on the liquidation of the Group's asset backed security proprietary trading portfolio. The portfolio was liquidated during the first quarter of the year thereby protecting the Bank against the further significant deterioration in the structured product markets in the second half of the year. The trading loss was also attributable to losses on externally managed funds of US$65.8 million. These losses principally




arose on alternative investment (hedge) funds. During the year, the Bank actively reduced its exposure to hedge funds. At 31st December 2008, the Group's hedge funds classified as held-for-trading had been reduced to US$152.8 million. The Bank is continuing to exit its investments in hedge funds at the earliest possible opportunity.

Foreign exchange profits, which were entirely customer-related, at US$16.1 million were US$6.4 million or 66 per cent up on the previous year. This was the highest ever level of foreign exchange earnings. All other trading activities incurred a marginal aggregate loss for the year reflecting the volatile and challenging market environment, particularly during the second half of the year.

Profits on investment securities amounted to US$39.4 million for the year. Profits principally arose on the sale of a strategic equity investment and on the early redemption of securities in the floating rate debt security portfolio.

Other income of US$8.4 million principally comprised profits realised on the sale of premises and equipment, loan recoveries and dividends received from equity investments.

## OPERATING EXPENSES

Operating expenses at US$142.9 million were only US$1.2 million up on the prior year. As explained in more detail later in this section, the year-on-year increase was recorded in the other operating expense category.

Staff expenses were US$3.3 million down on the prior year. Staff expenses in 2007 included a one off, exceptional expense of US$4.0 million relating to the restructuring of the Group's London-based subsidiary, GIBUK. Excluding this exceptional expense, staff expenses were at much the same level as in the prior year reflecting cost control measures. Premises expenses were US$0.7 million or 6 per cent down on the prior year reflecting general cost savings.

Other operating expenses were US$5.7 million up on the prior year. This was partly attributable to the benefit of an exceptional, one off VAT refund in 2007 expenses. In addition, 2008 expenses included exceptional consultancy fees relating to the investment securities portfolio and strategic initiatives.

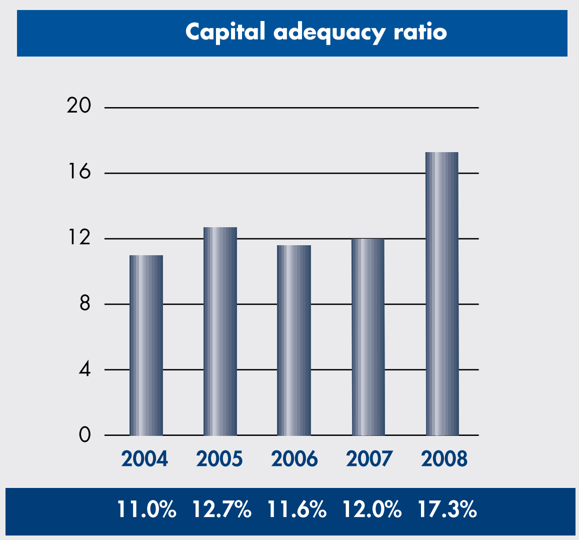
## PROVISIONS

The Bank took prudent and conservative provisioning actions in relation to investment security exposures that were adversely impacted by the credit market crisis and also in anticipation of a potential increase in corporate defaults in the deteriorating economic environment.

The total provision charges in 2008 for investment securities and loans and advances were US$365.1 million and US$201.7 million respectively.

The provision charge for investment securities largely related to collateralised debt obligations (CDOs), asset backed securities and impaired financial institution securities that were sold effective 31st December 2008. The securities were sold at their amortised cost less specific provisions for impairment as at the effective date of sale.

The loan provision charge comprised specific provisions of US$86.7 million and a net increase in the non-specific loan provision of US$115.0 million. The specific provision charge largely related to one corporate exposure that is in the process of being rescheduled. As commented on in more detail in the loans and advances section of the Financial Review, the significant increase in the non-specific loan provision reflected increases in the expected probabilities of default used in the calculation of provisions measured on a collective basis. Higher probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment. While the Bank's lending activities are primarily focussed on providing financing to key infrastructure projects, shareholder-related entities and top tier corporates, it was nevertheless considered prudent to




*From 2008, the capital adequacy ratio is calculated in accordance with the CBB's Basel 2 guidelines. Comparative ratios are presented in accordance with the Basel 1 guidelines of the Basel Committee on Banking Supervision.*

enhance provisions in order to provide a conservative buffer as the Bank enters a potentially uncertain environment.

## CAPITAL STRENGTH

Total equity amounted to US$1,925.5 million at 31st December 2008. At the 2008 year end the ratio of equity and Tier 1 capital to total assets were 7.7 per cent and 7.9 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 4.5 per cent according to a survey published in *The Banker* magazine in July 2008.

Issued share capital increased by US$1.0 billion during the year following the completion of the legal formalities relating to a capital increase ratified by the shareholders of the Bank in February 2008. The capital increase was classified in the consolidated balance sheet at 31st December 2007 as a proposed increase in share capital pending completion of the relevant legal formalities.

A US$289.8 million decrease in total equity during 2008 comprised the net of the US$396.2 million loss for the year, and a US$106.4 million net increase in the fair value of available-for-sale securities and derivative cash flow hedges. In accordance with IAS 39, changes in the fair values of available-for-sale securities and derivative cash flow hedges are accounted for in equity. The net increase in the fair value of available-for-sale securities largely reflected the beneficial impact of the sale of a significant portion of the investment securities portfolio effective December 2008. The unrealised revaluation loss on available-for-sale securities at the 2008 year end was US$67.1 million, representing only 3 per cent of the total value of the available-for-sale securities portfolio. The relatively small unrealised revaluation loss reflected the high quality of the remaining securities portfolio following the sale of securities in December 2008. The remaining available-for-sale securities principally comprised investment grade-rated debt securities issued by major international financial institutions and government-related entities.

With a total regulatory capital base of US$2,747.9 million and total risk-weighted exposure of US$15,894.2 million, the risk asset ratio calculated in accordance with the Central Bank of Bahrain's Basel 2 guidelines was 17.3 per cent while the Tier 1 ratio was a strong 12.5 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 2008 year end net fair value losses of US$59.9 million were added back to 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 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 both market and operational risk-weighted exposures. The Basel 2 Pillar 3 report set out in a later section of the Annual Report provides further details on capital adequacy and the Bank's capital management framework. The Group's policies in relation to capital management are set out in note 26 to the consolidated financial statements. As described in more detail in the note, the Group's policy is to maintain a strong capital base so as to maintain investor, counterparty and market confidence and to sustain the future development of the Group's business.

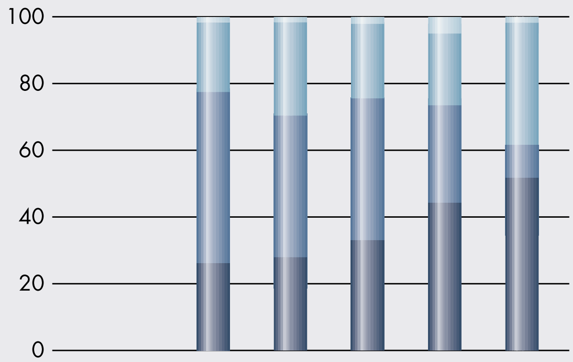
## ASSET QUALITY

The geographical distribution of risk assets is set out in note 27 to the consolidated financial statements. The credit risk profile of financial assets, based on internal credit ratings, is set out in note 26(a) to the consolidated financial statements. This note demonstrates that 83 per cent of all financial assets, comprising placements, securities and loans, were rated 4- or above, i.e. the equivalent of investment grade-rated. Further assessment of asset quality can be facilitated by reference to note 36 to the consolidated financial statements on the fair value of financial instruments.

Based on the valuation methodologies set out in that note, the net fair values of all on- and off-balance sheet financial instruments at 31st December 2008 were not significantly different to their carrying amounts. All non-trading securities are classified as available-for-sale and measured at fair value. Available-for-sale securities are accordingly stated at fair value in the consolidated balance sheet.

At the 2008 year end, placements and available-for-sale securities accounted for 16 per cent and 9 per cent of total assets respectively while loans and advances represented 52 per cent.

**Asset mix by category (%)**




| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| Other | 1.5 | 1.6 | 2.0 | 5.1 | 1.8 |
| Placements, due from shareholders, due from brokers, and other liquid assets | 20.9 | 27.9 | 22.4 | 21.4 | 36.7 |
| Securities | 52.4 | 43.1 | 42.8 | 31.4 | 9.7 |
| Loans and advances | 25.2 | 27.4 | 32.8 | 42.1 | 51.8 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

### *Investment Securities*

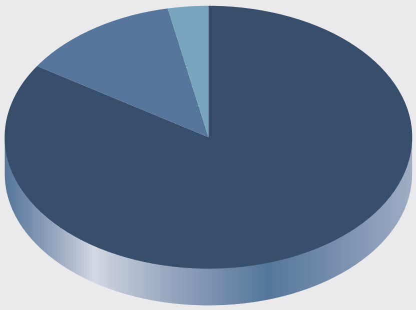
Investment securities totalled US$2,220.5 million at 31st December 2008. The investment securities portfolio, which is entirely classified as available-for-sale, principally comprised investment grade-rated debt securities issued by major international financial institutions and government related entities.

Based on an agreement effective 31st December 2008, the Group sold, without recourse, a significant portion of its investment securities portfolio to shareholders of the Bank. The securities were sold at their amortised cost less specific provisions for impairment as at the effective date of sale. Accordingly, no profit or loss was recorded on the transaction. The sold securities comprised the Bank's entire exposure to collateralised debt obligations (CDOs) and other asset backed securities, other than those sold or maturing prior to the settlement date of the sale of the securities on 27th March 2009, investments in non-GCC financial institution subordinated debt and impaired financial institution senior debt. Following the sale, the Group had no exposure, net of specific provisions, to collateralised debt obligations or other asset backed securities. The sale is commented on in more detail in note 7 to the consolidated financial statements.

An analysis of the basis used for determining the fair values of investment securities is set out in note 36 to the consolidated financial statements. At 31st December 2008, US$1,966.2 million or 89 per cent of investment securities were valued based on quoted prices while an additional US$204.7 million or 9 per cent was valued based on cost less provisions for impairment. Only US$49.6 million was based on observable market data, representing private equity fund investments for which the fair values were based on the net asset values of the investment vehicles. No fair values of available-for-sale securities at 31st December 2008 were derived from modelled-based valuation methodologies.

Investment securities comprise two types of debt security portfolios and a limited investment in equities and equity funds. The larger debt security portfolio comprises floating rate securities or fixed rate securities that have been swapped to yield constant spreads over LIBOR. These accounted for 82 per cent of the total investment securities portfolio at the 2008 year end. The smaller debt security portfolio comprises fixed income securities. This portfolio amounted to US$201.4 million at the end of 2008. This largely comprised GCC government-related bonds.

**Investment debt securities rating profile**



| | US$ millions | % |
|---|---|---|
| AAA to A- / Aaa to A3 | 1,690.4 | 84.1 |
| BBB+ to BBB- / Baa1 to Baa3 | 256.4 | 12.7 |
| Other debt securities | 64.4 | 3.2 |
| **Total** | **2,011.2** | **100.0** |

Equity investments amounted to US$209.3 million at the end of 2008 and comprised private equity investments and externally managed funds providing a diversified exposure to the private equity sector.

An analysis of the investment securities portfolio by rating category is set out in note 9(a) to the consolidated financial statements. US$1,690.4 million or 84 per cent of the debt securities at the 2008 year end were rated A- or above. Based on the rating of the issuer, a further US$256.4 million or 13 per cent of the debt securities represented other investment grade-rated securities. Thus 97 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$64.4 million at the end of 2008, thus comprising only 3 per cent of the total investment debt securities portfolio. These largely comprised securities issued by unrated GCC entities.

There were no past due securities, net of specific provisions, at 31st December 2008. Impaired investment securities, representing securities against which a specific provision is maintained, amounted to US$669.8 million at 31st December 2008. This principally comprised investments in structured investment vehicles (SIVs) of US$564.5 million. The SIVs were fully provisioned. Total specific provisions for impairment at 31st December 2008 represented 96 per cent of gross impaired investment securities.

### *Loans and Advances*

Loans and advances amounted to US$12,972.1 million at the 2008 year end. This represented a US$370.3 million or 3 per cent increase compared to the 2007 year end. 94 per cent of the loan portfolio at the 2008 year end represented lending within GIB's core market in the GCC states.

Based on contractual maturities at the balance sheet date, 46 per cent of the loan portfolio was due to mature within one year while 67 per cent was due to mature within three years. Only 21 per cent of loans were due to mature beyond five years. Details of the classification of loans and advances by industry are set out in note 10(a) to the consolidated financial statements while the geographical distribution of loans and advances is contained in note 27. At 31st December 2008, 25 per cent of the loan portfolio comprised exposure to the energy, oil and petrochemical sector. This reflects the Group's strategic focus on project finance and syndicated lending in the GCC states.

The credit risk profile of loans and advances, based on internal credit ratings, is set out in note 26(a) to the consolidated financial statements. US$9,378.3 million or 72 per cent of total loans were rated 4- or above, i.e. the equivalent of investment grade-rated. All but US$107.7 million were classified as standard. The classified loan exposures principally comprised one corporate exposure that is subject to rescheduling discussions and two regional investment companies that are similarly considering rescheduling options in view of short term liquidity constraints.

Total loan loss provisions at 31st December 2008 amounted to US$274.2 million. Counterparty specific provisions amounted to US$94.2 million while non-specific provisions were US$180.0 million. Total specific provisions of US$94.2 million significantly exceeded the gross book value of past due loans of only US$6.0 million. Specific provisions were therefore maintained against loans that were not past due in respect of either principal or interest.

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.

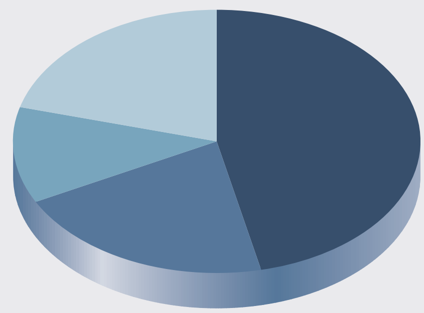
There was a net US$115.0 million increase in non-specific loan provisions during 2008 to US$180.0 million at the 2008 year end. The increase in the non-specific provision was based on increases in the expected probabilities of default used in the calculation of provisions for impairment measured on a collective basis. Higher probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment.

The probabilities of default applied in the calculation of the non-specific provisions at 31st December 2008 equated to a speculative-grade default rate of 13.9 per cent, exceeding the previous high corporate default rates witnessed in July 1991. The default rates applied in the calculation of the non-specific loan provision and the resultant provisioning levels for senior, unsecured exposure by internal rating category were as follows:-

| Internal rating grade | Probability of default (PDs) | Senior, unsecured provisioning level % |
|---|---|---|
| 1 | 0.03% | - |
| 2 + | 0.03% | - |
| 2 | 0.03% | - |
| 2 - | 0.06% | - |
| 3 + | 0.18% | 0.1% |
| 3 | 0.34% | 0.2% |
| 3 - | 0.36% | 0.2% |
| 4 + | 1.02% | 0.7% |
| 4 | 1.05% | 0.7% |
| 4 - | 1.29% | 0.8% |
| 5 + | 2.25% | 1.5% |
| 5 | 3.48% | 2.3% |
| 5 - | 6.21% | 4.0% |
| 6 + | 9.87% | 6.4% |
| 6 | 27.93% | 18.2% |
| 6 - | 39.45% | 25.6% |
| 7 | 83.61% | 54.3% |

The provisioning level is based on a Loss Given Default (LGD) of 65 per cent for senior, unsecured exposure.

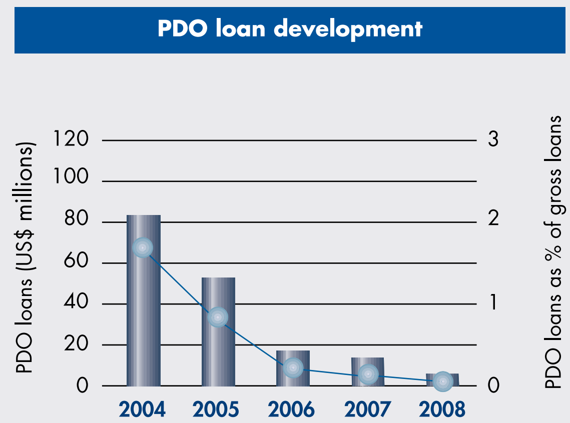
**Loan maturity profile**



| | US$ millions | % |
|---|---|---|
| Year 1 | 6,027.7 | 46.5 |
| Years 2 & 3 | 2,712.5 | 20.9 |
| Years 4 & 5 | 1,539.1 | 11.8 |
| Over 5 years | 2,692.8 | 20.8 |
| **Total** | **12,972.1** | **100.0** |

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

The gross and net book values of past due loans amounted to US$6.0 million and US$1.0 million respectively. The provisioning coverage for past due loans was therefore 85 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




| | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---|---|---|---|---|
| PDO loans | 84.0 | 53.7 | 18.7 | 17.0 | 6.0 |
| % of gross loans | 1.69% | 0.84% | 0.22% | 0.13% | 0.05% |

in note 10(c) to the consolidated financial statements. No new loans became past due in 2008. All past due loans were overdue by between two and five years. 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$268.2 million. This means that rather than earnings being impaired by the funding cost of the net book value of past due loans, there is an earnings enhancement.

### *Other Asset Categories*

Cash and other liquid assets, which amounted to US$303.0 million at the 2008 year end, are analysed in note 5 to the consolidated financial statements. They principally comprised cash and balances with banks.

Placements with banks totalled US$4,037.4 million at the 2008 year end and were well diversified by geography as illustrated in note 27 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 16 per cent of total assets at the 2008 year end.

The amount due from shareholders at 31st December 2008 is commented on in more detail in note 7 to the consolidated financial statements. This represented an amount due in relation to the sale of securities as referred to earlier in the Financial Review commentary. The total amortised cost less specific provisions for impairment of the sold securities at the effective date of sale on 31st December 2008, based on rates of exchange prevailing on that date, was US$4,832.0 million. The amount due from shareholders was settled on 27th March 2009.

Trading securities at US$207.1 million comprised funds managed by international institutions with acknowledged expertise in their field, providing diversified exposure to alternative investment strategies and international debt markets. During 2008, the Bank's investments in hedge funds were reduced from US$334.0 million at the end of 2007 to US$153.0 million at the 2008 year end. The Bank is continuing to reduce its investments in hedge funds with the intention of fully exiting the investments at the earliest possible opportunity.

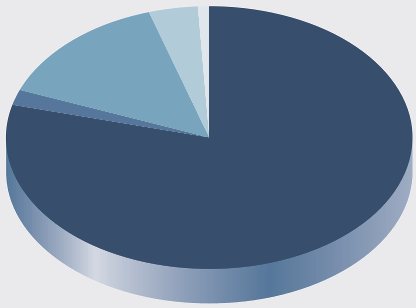
### *Risk Asset and Commitment Exposure*

Risk asset and commitment exposure at 31st December 2008 amounted to US$28,209.6 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of other assets) and credit-related contingent items. As referred to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 27 to the consolidated financial statements. As is evident from this note, US$22,272.7 million or 79 per cent of total risk assets and commitments represented exposure to counterparties and entities located in the GCC states. The remaining risk asset exposure largely represented short term interbank placements with major European banks. An analysis of derivative and foreign exchange products is set out in note 30 while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 31.

## FUNDING

Bank and customer deposits at 31st December 2008 totalled US$18,395.0 million. Customer deposits amounted to US$15,009.1 million at the 2008 year end being US$1,335.1 million higher than at the previous year end. Customer deposits at US$15,009.1 million represented 82 per cent, or well over three quarters, of total deposits. A lower funding requirement resulting from the cessation of proprietary trading activities and the liquidation of related trading assets as well as a decrease in investment securities as a result of ongoing maturities, contributed to a reduction

**Risk asset and commitment exposure**



| | US$ millions | % |
|---|---|---|
| GCC | 22,272.7 | 79.0 |
| Other Middle East & North Africa | 543.9 | 1.9 |
| Europe | 4,040.0 | 14.3 |
| North America | 1,090.6 | 3.9 |
| Asia | 262.4 | 0.9 |
| **Total** | **28,209.6** | **100.0** |

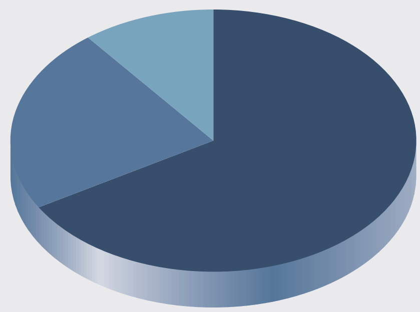
in bank deposits. Bank deposits at 31st December 2008 amounted to US$3,385.9 million, representing only 18 per cent of total deposits.

Total deposits are analysed by geography in note 13 to the consolidated financial statements. US$12,223.4 million or 66 per cent of total deposits were derived from counterparties in GCC countries while a further US$4,213.9 million were derived from the wider Middle East and North Africa. Deposits derived from other countries, principally Europe, amounted to US$1,957.7 million or only 11 per cent of total deposits. This compares to placements with non-GCC counterparties of US$3,510.4 million. The Group is therefore a net placer of funds in the international interbank markets, and has no net reliance on the international interbank market. This helped to protect the Bank during the unprecedented liquidity squeeze and associated drying up of liquidity in international interbank markets witnessed in the latter part of 2008.

Securities sold under agreements to repurchase (repos) were US$1,244.8 million at 31st December 2008. A significant decrease in repos at the 2008 year end was attributable to the sale of a significant portion of the investment securities portfolio effective 31st December 2008. The Bank continues to utilise its remaining high quality and highly rated investment securities to raise funding on a collateralised basis where effective from a cost and tenor perspective.

Senior term financing at 31st December 2008 totalled US$2,431.5 million. Only US$306.9 million of senior term financing is due to mature in 2009. US$1,200.0 million, or almost half, of the Group's senior term financing is not due to mature until 2012. Further commentary on liquidity and funding is provided in the Basel 2 Pillar 3 report.

**Deposits - geographical profile**



| | US$ millions | % |
|---|---|---|
| GCC | 12,223.4 | 66.5 |
| Other Middle East & North Africa | 4,213.9 | 22.9 |
| Other countries | 1,957.7 | 10.6 |
| **Total** | **18,395.0** | **100.0** |

# *Loyalty*

Adherence to a strict form and the rules of geometry mean that there is no deviation away from an ideal.

## SOUND GOVERNANCE

GIB has long recognised the importance of sound corporate governance as a critical factor in attaining fairness for all stakeholders and achieving organisational integrity and efficiency, and the Board of Directors and Management are committed to complying with established best practice in that regard.

Although not a publicly traded company, GIB has progressively adopted and implemented international best practices of publicly traded financial institutions, and since 2003 has published a statement on Corporate Governance in its Annual Report.

During 2008, GIB continued to work on new initiatives aimed at promoting enhanced corporate governance practices, with particular emphasis on increasing the awareness and understanding of directors, management and staff on this important topic.

In addition, a number of steps were taken to further strengthen GIB's corporate governance framework, ranging from self-assessments at all levels to ensure compliance with the requirements of the Central Bank of Bahrain ("CBB") on corporate governance, to specific milestones such as the adoption of a Disclosure Policy in accordance with the requirements of Basel 2 Pillar 3 to reflect the Bank's commitment to enhancing corporate governance, financial transparency, and fairness in the disclosure of financial information for the benefit of all users of that information, including regulators, customers, counterparties, rating agencies and other stakeholders.

## ORGANISATION

The Bank has a corporate governance structure in place that segregates functions and responsibilities, reflecting the necessary 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, which receives from Management such information as is required to properly fulfill its duties and the duties of the Committees that assist it, and which delegates to Management the authority and responsibility for managing the day-to-day business of the Bank.
- There is an effective and appropriately organised management structure responsible for the day-to-day management of the Bank and the implementation of Board-approved strategy, policies and internal controls.
- There is a clear division of roles and responsibilities as between the Board of Directors and Management, and as between the Chairman and the Chief Executive Officer ("CEO").
- There are defined and documented mandates and responsibilities (as well as delegated authorities, where applicable) for:
  - The Board
  - The Chairman of the Board
  - The Board Committees
  - The Management
  - The Chief Executive Officer
  - The six Management Committees (Management Committee, Group Risk Committee, Assets & Liabilities Committee, Information Security Management Committee, Information Technology Steering Committee and Human Resources Committee).

The organisation chart and corporate governance structure is set out on page 112 of this Annual Report.

## BOARD OF DIRECTORS

The Board comprises ten 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 113 of this Annual Report.

In accordance with the Bank's Articles of Association, Directors are appointed by the Bank's shareholders who consist of the six Gulf Cooperation Council governments, namely Saudi Arabia (Saudi Arabian Monetary Agency (SAMA) and Public Investment Fund (PIF)), Kuwait (Kuwait Investment Authority), Qatar (Qatar Investment Authority), Bahrain (Bahrain Mumtalakat Holding Company B.S.C.), Oman (Ministry of Finance of the Sultanate of Oman), and the United Arab Emirates (Ministry of Finance of the United Arab Emirates).

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

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

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

In fulfillment of the requirements of the corporate governance rules of the CBB, Letters of Appointment are issued by the Chairman to all the Directors:

- First, reminding them that Directors are responsible for contributing to the oversight of the Bank's affairs with professionalism and integrity with the aim of achieving the strategic and financial objectives adopted by the Board;
- Second, pointing out that a key responsibility of the Board is to fill the gap between stakeholders (shareholders, creditors, employees, customers, etc.) to whom the Board owes a duty of care, and executive management, by monitoring management closely on behalf of stakeholders; and
- Third, drawing attention to the fact that a detailed description of Directors' responsibilities is outlined in the Mandate of the Board and in the Mandate of Directors, as adopted by the Board; and that these responsibilities are to be carried out in line with the standards of the Code of Conduct adopted 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 2008, the Board met ten times, the Audit Committee met five times, the Risk Policy Committee met five times, and the Human Resources & Compensation Committee met twice.

The details of Committee membership and Directors' attendance are set out in the table on page 25.

## BOARD COMMITTEES

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

### *The Audit Committee*

The mandate of the Audit Committee requires it to:

- Assist the Board in fulfilling its statutory and fiduciary responsibilities with respect to internal controls, accounting policies, auditing and financial reporting practices.
- Assist 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.
- Review the activities and performance of the internal audit function.

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 CEO.

## DIRECTORS' ATTENDANCE DURING 2008

Board and Committee meetings attendance during 2008

| Board Members | Board meetings | Audit Committee meetings | Human Resources & Compensation Committee meetings | Risk Policy Committee meetings | Executive** Committee meetings |
|---|---|---|---|---|---|
| H.E. Mr. Jammaz bin Abdullah Al-Suhaimi - Chairman (from May 2008) *(Saudi Arabian Monetary Agency)* | 6 (6) | | | | |
| H.E. Sheikh Ebrahim bin Khalifa Al Khalifa (Chairman until 30th April 2008) *(Ministry of Finance, Bahrain)* | 4 (4) | | | | 6 (6)* |
| Mr. Abdul Aziz M. Al-Abdulkader - Vice Chairman *(Saudi Arabian Monetary Agency)* | 10 (10) | | | 1 (1) | |
| Dr. Hamad bin Sulaiman Al-Bazai *(Public Investment Fund, Saudi* Arabia) | 8 (10) | 5 (5)* | 2 (2) | | |
| Mr. Saud bin Nassir Al-Shukaily *(Ministry of Finance, Oman)* | 8 (10) | 5 (5) | | 2 (4) | |
| Mr. Khalid bin Abdulla Al-Sowaidi *(Qatar Investment Authority, Qatar)* | 10 (10) | | 2 (2) | 5 (5) | |
| Mr. Nasser Khamis Al-Suwaidi *(Ministry of Finance, UAE)* | 10 (10) | 5 (5) | 2 (2)* | | |
| Dr. Khalid Abdulla Al-Sweilem *(Saudi Arabian Monetary Agency)* | 10 (10) | 5 (5) | 1 (2) | 5 (5)* | 9 (9) |
| H.E. Dr. Abdul Rahman bin Ahmed Al-Jafary *(Saudi Arabian Monetary Agency)* | 10 (10) | | 2 (2) | 3 (5) | |
| Mr. Ahmed Tahous Al-Rashed Al-Tahous *(Kuwait Investment Authority, Kuwait)* | 9 (10) | 4 (5) | | 4 (5) | 9 (9) |
| Mr. Khalil Ebrahim Nooruddin *(Bahrain Mumtalakat Holding Co., Bahrain)* ***Note:*** Mr. Nooruddin joined as Board member on 26th November 2008. | 1 (1) | | | 1 (1) | |

* Committee Chairman

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

**** Executive Committee:** A special executive committee of the Board composed of three Directors (mentioned under the Executive Committee column in the above chart) with Dr. Khaled Al-Fayez, CEO and Mr. Matthew Snyder, Managing Director, met nine times in 2008 to review the impact on the Bank of the sub-prime mortgage crisis and the global financial downturn, and to examine the report of special consultants engaged to assist in the formulation of the strategy to be adopted by the Bank, with a view to recommend appropriate action to the Board. The Executive Committee was disbanded in July 2008 as the full Board took over the Committee's work.

### *The Human Resources & Compensation Committee*

The mandate of the Human Resources & Compensation Committee requires it to:

- Assist the Board in fulfilling its responsibilities for the Bank's human resources and remuneration policies.
- Review the Bank's human resources and compensation policy proposals, and make the necessary recommendations in that regard for approval by the Board.
- Ensure 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.
- Monitor the overall cost of remuneration structures of the Bank.
- Ensure that effective management systems are in place to monitor and evaluate the performance of staff.
- Review the Bank's succession plan report for submission to the regulators.

### *The Risk Policy Committee*

The mandate of the Risk Policy Committee requires it to:

- Assist 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.
- Ensure 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.
- Ensure that realistic policies in respect of management of all significant risks are drafted and approved appropriately.
- Review the Bank's risk profile and significant risk positions.
- Approve with management the overall credit risk policy limits.
- Receive, review, challenge and recommend for approval, by the full Board, any proposed amendments to the overall risk appetite for the Bank.
- Ensure that roles and responsibilities for risk management are clearly defined, and that they remain independent of business development.
- Ensure that, on a timely basis, management informs the Committee of all significant risk arising and that it is comfortable with management's responses and action taken to address such findings.
- Ensure that management reports significant excesses and exceptions, as and when they arise, to the Committee for information and review.
- Monitor whether management maintains a culture that rewards the recognition, communication and management of risks.

## MANAGEMENT

The Senior Management team, 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, the Chief Financial Officer, the Chief Investment & Treasury Officer, the Managing Director - Risk Management, the Managing Director - Merchant Banking, and the Managing Director - Operations & Administration. Their biographies are set out on page 114 of this Annual Report. *It was announced on 1st December 2008 that the Chief Executive Officer, Dr. Khaled Al-Fayez, would retire at the end of December 2008 after working for more than 35 years in the banking industry, and that Dr. Yahya Alyahya would become the new Chief Executive Officer of GIB on 1st January 2009.*

Six committees assist the Chief Executive Officer in the management of the Bank:

- Management Committee
- Group Risk Committee
- Assets and Liabilities Committee (ALCO)
- Human Resources Committee
- Information Technology Steering Committee
- Information Security Management Committee

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

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

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

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

## STAFF COMPENSATION

In line with industry best practice and in consultation with external independent remuneration consultants, GIB has established a comprehensive staff compensation policy based on total compensation.

The scheme consists of the following for all staff except the CEO:

- A fixed component representing basic pay, allowances and benefits, that are reviewed and compared annually with market levels, based on an independent market survey and adjusted as appropriate.
- 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 scheme is based on defined quantitative as well as qualitative measures.
- Based on established criteria, the performance bonus of the Managing Directors are recommended by the CEO for review and endorsement by the Board's Human Resources and Compensation Committee, subject to Board approval.
- Annually, the Human Resources and Compensation Committee reviews Management proposals with regard to long term retention incentives and makes necessary recommendations for Board approval.

## CEO COMPENSATION

- The CEO is appointed by the Board of Directors for a term of 3 years. Renewal is considered prior to the expiration of each term.
- The fixed compensation components are negotiated and determined at time of renewal, with the assistance and input from independent external compensation evaluation experts.
- The performance bonus of the CEO is recommended by the Board's Human Resources and Compensation Committee, and approved by the Board based on the established scheme mechanism approved by the Board.

## BOARD OF DIRECTORS COMPENSATION

To assist with establishing the appropriate structure and level of compensation, independent external consultants are involved to advise on market practice and provide suggestions. Generally, the compensation is linked to actual attendance of meetings.

The structure and level of the compensation for the members of the Board of Directors are approved by the AGM and consist of the following:

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

## 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 objective, best summarised as follows: *to become the GCC merchant bank of choice, with market leadership in a diversified portfolio of activities*.

Within that objective, every year the Board of Directors reassesses and approves a detailed strategic plan that covers the planned activities of the Bank for the next three years, in light of changing global and regional market conditions. Given the current financial crisis, the Board is in the process of conducting this reassessment of strategy and objectives.

## COMPLIANCE

The Board has adopted a Compliance framework that reflects the principles for promoting sound compliance practices at GIB, which demonstrates the Bank's adherence to applicable legal and regulatory requirements and to high professional standards. The role of the Compliance function is to assist senior management to ensure that the activities of GIB and its staff are conducted in conformity with applicable laws and regulations, and generally with sound practices pertinent to those activities. The Head of Compliance (Bahrain), who reports directly to the Chief Executive Officer, also has access to the Board of Directors through the Audit Committee, if required.

In ensuring that the tone emanates from the top, the Chief Executive Officer issues a yearly message to all of GIB reminding everyone of the importance of complying with all laws and regulations applicable to GIB's operations, and good compliance behaviour is rewarded by making it a mandatory measurement item in staff evaluations.

## ANTI-MONEY LAUNDERING

The Bank's current anti-money laundering and combating the financing of terrorism (AML/CFT) procedures and guidelines conform to the legal and regulatory requirements of the Kingdom of Bahrain. These legal and regulatory requirements largely reflect the FATF recommendations on Money Laundering and special recommendations on Terrorist Financing.

The GIB AML/CFT procedures and guidelines apply to all of the Bank's offices, branches and subsidiaries (collectively "GIB entities"), wherever located. In addition, the GIB entities located outside Bahrain are subject to the laws and requirements of the jurisdictions where they operate, and if local standards differ, the higher standards should apply.

Systems are in place to ensure that business relationships are commenced with clients whose identity and activities can reasonably be established to be legitimate, to collect and record all relevant client information, to monitor and report suspicious transactions, to provide periodic AML/CFT training to employees, and to review with external auditors the effectiveness of the AML/CFT procedures and controls. The GIB AML/CFT procedures prohibit dealing with shell banks.

A proactive structure of officers is in place to ensure group-wide compliance with AML/CFT procedures, and the timely update of the same to reflect the changes in regulatory requirements. This structure consists of the Head of Compliance (Bahrain) and Group Money Laundering Reporting Officer, MLROs, Deputy MLROs, and Compliance Officers.

## CORPORATE COMMUNICATIONS

The Bank has in place a Corporate Communications policy in line with the requirements of the Central Bank of Bahrain, to ensure that the disclosures made by the Bank are fair, transparent, comprehensive and timely, and reflect the character of the Bank and the nature, complexity and risks inherent in its business activities. Main communication channels include an Annual Report, corporate brochure, newsletter, and announcements in the appropriate media.

This transparency is also reflected in the Bank's website (www.gibonline.com) that provides substantial information on the Bank, including its profile and milestones, statements on its vision, mission, strategy and objectives, its Code of Conduct, its press releases, as well as its financial statements.

## DISCLOSURES

The Bank's website also provides the Bank's Annual Reports, and all the information contained in these reports is therefore accessible globally. That information includes management discussion on the business activities of the Bank, as well as discussion and analysis of the financial statements and risk management. The financial information reflects the latest international accounting standards requirements, including the increased level of disclosure resulting from the adoption of IFRS 7 - Financial Instruments Disclosures, such as the disclosures on related party transactions in note 35 to the consolidated financial statements.

As mentioned earlier, in 2008 the Board has also adopted a Disclosure Policy in accordance with the requirements of Basel 2 Pillar 3. The objective of that Policy is to ensure transparency in the disclosure of the financial and risk profiles of the Bank to all interested parties.

## CODE OF CONDUCT

Finally, the Bank's website also contains the Code of Conduct that was approved by the Board, 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 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 whistle-blowing.

Members of staff can also access the Code of Conduct on the GIB intranet, where it is available in both English and Arabic.

# *Excellence*

This is shown in the fine, yet intricate detail of the arabesque.

# Financial Statements

## Contents

# Independent Auditor's Report 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 2008, and the consolidated statements of income, cash flows and the 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 control 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.

***Auditor's 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 control 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 control. 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 financial position of the Group as at 31st December 2008, and of its financial performance and its 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 2008 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**
Public Accountants
Manama, Kingdom of Bahrain
5th March 2009

# Consolidated Balance Sheet

| | Note | At 31.12.08 US$ millions | At 31.12.07 US$ millions |
|---|---|---|---|
| **Assets** | | | |
| Cash and other liquid assets | 5 | **303.0** | 532.7 |
| Due from brokers | | **-** | 243.3 |
| Placements with banks | 6 | **4,037.4** | 5,629.1 |
| Due from shareholders | 7 | **4,832.0** | - |
| Trading securities | 8 | **207.1** | 1,342.6 |
| Investment securities | 9 | **2,220.5** | 8,070.7 |
| Loans and advances | 10 | **12,972.1** | 12,601.8 |
| Other assets | 11 | **461.4** | 1,533.8 |
| **Total assets** | | **25,033.5** | 29,954.0 |
| **Liabilities** | | | |
| Deposits from banks | 13 | **3,385.9** | 5,970.7 |
| Deposits from customers | 13 | **15,009.1** | 13,674.0 |
| Securities sold under agreements to repurchase | 14 | **1,244.8** | 4,141.5 |
| Securities sold but not yet purchased | | **-** | 233.2 |
| Other liabilities | 15 | **486.7** | 511.5 |
| Senior term financing | 16 | **2,431.5** | 2,657.8 |
| Subordinated term financing | 17 | **550.0** | 550.0 |
| **Total liabilities** | | **23,108.0** | 27,738.7 |
| **Equity** | | | |
| Share capital | 18 | **2,500.0** | 1,500.0 |
| Proposed increase in share capital | 18 | **-** | 1,000.0 |
| Share premium | | **7.6** | 7.6 |
| Reserves | 19 | **216.0** | 109.6 |
| Retained earnings | | **(798.1)** | (401.9) |
| **Total equity** | | **1,925.5** | 2,215.3 |
| **Total liabilities & equity** | | **25,033.5** | 29,954.0 |

The consolidated financial statements were approved by the Board of Directors on 5th March 2009 and signed on their behalf by:-

Jammaz bin Abdullah Al-Suhaimi
Chairman

Yahya bin Abdullah Alyahya
Chief Executive Officer

The notes on pages 37 to 80 form part of these consolidated financial statements.

# Consolidated Statement of Income

| | Note | Year ended 31.12.08 US$ millions | Year ended 31.12.07 US$ millions |
|---|---|---|---|
| Interest income | 21 | **1,222.0** | 1,512.7 |
| Interest expense | 21 | **933.7** | 1,207.1 |
| **Net interest income** | | **288.3** | 305.6 |
| Fee and commission income | 22 | **73.3** | 88.1 |
| Net trading loss | 23 | **(86.7)** | (86.6) |
| Profits on investment securities | | **39.4** | 29.6 |
| Other income | 24 | **8.4** | 5.7 |
| **Total income** | | **322.7** | 342.4 |
| Staff expenses | | **95.0** | 98.3 |
| Premises expenses | | **10.4** | 11.1 |
| Other operating expenses | | **37.5** | 31.8 |
| **Total operating expenses** | | **142.9** | 141.2 |
| **Net income before provisions and tax** | | **179.8** | 201.2 |
| Provisions for investment securities | 9 | **(365.1)** | (965.7) |
| Provisions for loans and advances | 10 | **(201.7)** | 6.9 |
| **Net loss before tax** | | **(387.0)** | (757.6) |
| Taxation (charge) / credit on overseas activities | | **(9.2)** | 0.3 |
| **Net loss** | | **(396.2)** | (757.3) |
| *Earnings per share* | 37 | ***(US$0.16)*** | *(US$0.55)* |

Jammaz bin Abdullah Al-Suhaimi
Chairman

Yahya bin Abdullah Alyahya
Chief Executive Officer

The notes on pages 37 to 80 form part of these consolidated financial statements.

# Consolidated Statement of Cash Flows

| | Year ended 31.12.08 US$ millions | Year ended 31.12.07 US$ millions |
|---|---|---|
| **Operating activities** | | |
| Net loss after tax | **(396.2)** | (757.3) |
| Adjustments to reconcile net loss to net cash inflow from operating activities: | | |
| Provisions for investment securities | **365.1** | 965.7 |
| Provisions for loans and advances | **201.7** | (6.9) |
| Profits on investment securities | **(39.4)** | (29.6) |
| Amortisation of investment securities | **0.7** | 2.6 |
| Decrease / (increase) in accrued interest receivable | **109.7** | (6.4) |
| (Decrease) / increase in accrued interest payable | **(77.2)** | 35.3 |
| Decrease / (increase) in other net assets | **36.7** | (127.6) |
| Net decrease in trading securities | **1,135.5** | 843.5 |
| **Net cash inflow from operating activities** | **1,336.6** | 919.3 |
| **Investing activities** | | |
| Net decrease in due from brokers | **243.3** | 707.6 |
| Net decrease / (increase) in placements with banks | **1,591.6** | (1,306.6) |
| Increase in due from shareholders | **(4,832.0)** | - |
| Net increase in loans and advances | **(572.0)** | (4,449.9) |
| Purchase of investment securities | **(462.4)** | (2,653.8) |
| Sale and maturity of investment securities | **6,071.3** | 1,815.4 |
| **Net cash inflow / (outflow) from investing activities** | **2,039.8** | (5,887.3) |
| **Financing activities** | | |
| Net (decrease) / increase in deposits from banks | **(2,584.9)** | 266.8 |
| Net increase in deposits from customers | **1,335.0** | 2,510.3 |
| Net (decrease) / increase in securities sold under agreements to repurchase | **(2,896.7)** | 1,921.9 |
| Net decrease in securities sold but not yet purchased | **(233.2)** | (629.5) |
| Net (decrease) / increase in senior term financing | **(226.3)** | 790.7 |
| Increase in share capital | **1,000.0** | 500.0 |
| Dividends paid | **-** | (127.7) |
| **Net cash (outflow) / inflow from financing activities** | **(3,606.1)** | 5,232.5 |
| **(Decrease) / increase in cash and cash equivalents** | **(229.7)** | 264.5 |
| **Cash and cash equivalents at 1st January** | **532.7** | 268.2 |
| **Cash and cash equivalents at 31st December** | **303.0** | 532.7 |

The notes on pages 37 to 80 form part of these consolidated financial statements.

# Consolidated Statement of Changes in Equity

| | Share capital US$ millions | Proposed increase in share capital US$ millions | Share premium US$ millions | Reserves US$ millions | Retained earnings US$ millions | Total US$ millions |
|---|---|---|---|---|---|---|
| **At 1st January 2007** | **1,000.0** | **-** | **7.6** | **365.9** | **483.1** | **1,856.6** |
| Arising in the year:- | | | | | | |
| - Available-for-sale securities: | | | | | | |
| net fair value losses | - | - | - | (248.8) | - | (248.8) |
| - Cash flow hedges: | | | | | | |
| net fair value gains | - | - | - | 1.3 | - | 1.3 |
| Transfers in the year:- | | | | | | |
| - Transfers to statement of income | - | - | - | (8.8) | - | (8.8) |
| Net losses recognised directly in equity | - | - | - | (256.3) | - | (256.3) |
| Net loss for the year | - | - | - | - | (757.3) | (757.3) |
| Total recognised expense for the year | - | - | - | (256.3) | (757.3) | (1,013.6) |
| Increase in share capital | 500.0 | 1,000.0 | - | - | - | 1,500.0 |
| Dividend for 2006 | - | - | - | - | (127.7) | (127.7) |
| **At 31st December 2007** | **1,500.0** | **1,000.0** | **7.6** | **109.6** | **(401.9)** | **2,215.3** |
| Arising in the year:- | | | | | | |
| - Available-for-sale securities: | | | | | | |
| net fair value gains | - | - | - | 8.2 | - | 8.2 |
| - Cash flow hedges: | | | | | | |
| net fair value gains | - | - | - | 10.5 | - | 10.5 |
| Transfers in the year:- | | | | | | |
| - Transfers to statement of income | - | - | - | 87.7 | - | 87.7 |
| Net gains recognised directly in equity | - | - | - | 106.4 | - | 106.4 |
| Net loss for the year | - | - | - | - | (396.2) | (396.2) |
| Total recognised income / (expense) for the year | - | - | - | 106.4 | (396.2) | (289.8) |
| Transfer to share capital | 1,000.0 | (1,000.0) | - | - | - | - |
| **At 31st December 2008** | **2,500.0** | **-** | **7.6** | **216.0** | **(798.1)** | **1,925.5** |

The notes on pages 37 to 80 form part of these consolidated financial statements.

For the year ended 31st December 2008

## 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 561.

## 2. ACCOUNTING POLICIES

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

### 2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards 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 as noted below.

In October 2008, the International Accounting Standards Board (IASB) amended IAS 39 - Financial Instruments: Recognition and Measurement to permit the reclassification of certain non-derivative financial assets in order to ensure consistency with US GAAP. The amendments were made in response to requests by regulators to enable banks to measure non-derivative financial assets which are no longer traded in an active market at amortised cost.

The amendments to IAS 39 permit the reclassification of non-derivative financial assets from held-for-trading to available-for-sale where the financial asset is no longer held for the purpose of sale in the near term. Such reclassifications are only permitted in rare circumstances. Rare circumstances are considered to arise from a single event that is unusual and highly unlikely to recur in the near term.

The amendment to IAS 39 in respect of the reclassification of trading securities that are no longer held for the purpose of sale in the near term was adopted with effect from 1st October 2008.

An amendment to International Financial Reporting Standard (IFRS) 7 - Financial Instruments: Disclosures introduced additional disclosure requirements for financial assets that are reclassified in accordance with the amendments to IAS 39. The relevant disclosures are set out in note 9 to the consolidated financial statements.

### 2.2 Consolidation principles

The consolidated financial statements include the accounts of Gulf International Bank B.S.C. and its subsidiaries. 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 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 gains and losses are included in trading income.

## 2. ACCOUNTING POLICIES (continued)

### 2.4 Financial assets and liabilities

Financial assets and liabilities comprise all assets and liabilities reflected on the balance sheet, although excluding investments in subsidiaries, associated companies and joint ventures, employee benefit plans, property and equipment, deferred taxation and taxation payable.

### a) Initial recognition and measurement

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

- held-for-trading
- loans and receivables
- available-for-sale securities

Financial assets are initially recognised at fair value, including transaction costs that are directly attributable to the acquisition of the financial asset.

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

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

### b) Subsequent measurement

Subsequent to initial measurement, financial assets and liabilities are measured at either fair value or amortised cost, depending on their classification:-

***Held-for-trading***

Held-for-trading financial assets and liabilities are assets or liabilities acquired or incurred 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.

Held-for-trading financial assets and liabilities are measured at fair value. The fair value for financial assets and liabilities traded in active markets is based on quoted prices, including quotations obtained from lead managers, brokers and dealers. The bid price is used to measure financial assets and the offer price is used to measure financial liabilities. Mid-market prices are used to measure fair value only to the extent that the Group has financial assets and liabilities with offsetting risk positions.

For all other held-for-trading financial assets and liabilities not traded in an active market, fair value is determined using appropriate valuation techniques. Valuation techniques include comparison to similar instruments for which there are observable prices, discounted cash flow techniques, and option pricing models.

Realised and unrealised gains and losses, interest earned or incurred, and dividends received on held-for-trading financial assets and liabilities are included in trading income.

***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those classified as held-for-trading. The majority of the Group's loans and receivables are included in the loans and advances balance sheet category.

Financial assets classified as loans and receivables are stated at amortised cost using the effective interest rate method as described in note 2.7(a), less provision for impairment, with interest revenue recognised in the consolidated statement of income.

## 2. ACCOUNTING POLICIES (continued)

### 2.4 Financial assets and liabilities (continued)

***Available-for-sale financial assets***

Available-for-sale financial assets are assets 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. Available-for-sale financial assets are measured at fair value. The fair value for available-for-sale financial assets in active markets is based on quoted prices, including quotations obtained from lead managers, brokers and dealers. The fair value for available-for-sale financial assets in inactive markets is determined using appropriate valuation techniques. Valuation techniques include comparison to similar instruments for which there are observable prices, and discounted cash flow techniques. 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 financial assets are recognised in a separate revaluation reserve in equity. The cumulative fair value adjustments on available-for-sale financial assets which are sold or otherwise disposed or become impaired, and which had previously been recognised in equity are transferred to the consolidated statement of income.

***Non-trading financial liabilities***

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

### c) Derecognition of financial assets and liabilities

Financial assets are derecognised and removed from the consolidated 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 consolidated balance sheet when the obligation is discharged, cancelled, or expires.

### 2.5 Impairment of financial assets

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. Objective evidence that a financial asset is impaired may include a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession, for economic or legal reasons relating to the borrower's financial difficulties, that would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. For equity securities classified as available-for-sale, a significant or prolonged decline in fair value below cost is considered in determining whether a security is impaired. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the consolidated statement of income. The amount of the cumulative loss that is removed from equity and recognised in the consolidated statement of income is the difference between the acquisition cost and current fair value, less any impairment loss on that security previously recognised in the consolidated statement of income.

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.

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

## 2. ACCOUNTING POLICIES (continued)

### 2.5 Impairment of financial assets (continued)

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

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.

Financial assets which have been renegotiated are no longer considered to be past due and are replaced on performing status when all principal and interest payments are up to date and future payments are reasonably assured. Financial assets subject to individual impairment assessment and whose terms have been renegotiated, are subject to ongoing review to determine whether they remain impaired or should be considered past due.

### 2.6 Offsetting financial assets and liabilities

Financial assets and financial 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 Revenue recognition

#### a) Interest income and interest expense

Interest income and interest expense for all interest-bearing financial assets and liabilities except those classified as 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 asset or liability but excluding future credit losses. Fees, including loan origination fees and early redemption fees, are included in the calculation of the effective interest rate to the extent that they are considered to be an integral part of the effective interest rate.

Interest income is suspended when either interest or principal on a credit facility is overdue by more than 90 days whereupon all unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities are restored to accrual status only after all delinquent interest and principal payments have been brought current and future payments are reasonably assured.

#### b) Fees and commissions

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

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

#### c) Net 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 net trading instruments are included in net trading income, together with the related interest income, interest expense and dividend income.

## 2. ACCOUNTING POLICIES (continued)

### 2.7 Revenue recognition (continued)

### d) Dividend income

Dividend income is recognised as follows:-

- dividends from structured finance investments are recognised when received and are included in interest income. The structured finance investments are in the form of capital notes.
- dividends from equity instruments classified as held-for-trading are recognised when the right to receive the dividend is established and are included in net trading income.
- dividends from equity instruments classified as available-for-sale are recognised when the right to receive the dividend is established and are included in other income.
- in the separate financial statements of the Bank, dividends from subsidiaries are recognised when received.

### 2.8 Securities financing arrangements

Securities purchased under agreements to resell (reverse repurchase agreements) and securities sold under agreements to repurchase (repurchase agreements) are treated as collateralised lending and borrowing transactions and are recorded in the consolidated 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.

### 2.9 Premises and equipment

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

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

### 2.10 Other provisions

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

### 2.11 Derivative financial instruments and hedge accounting

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

## 2. ACCOUNTING POLICIES (continued)

### 2.11 Derivative financial instruments and hedge accounting (continued)

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 net 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 consolidated statement of income and are included in the same income or expense category as the hedged item. Unrealised gains or losses on any ineffective portion of cash flow hedging transactions are included in net trading income.

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

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

Some hybrid instruments contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. If the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is bifurcated and measured at fair value. If it is not practically possible to bifurcate the embedded derivative, the entire hybrid instrument is categorised as held-for-trading and measured at fair value. Changes in fair value are included in net trading income.

### 2.12. Financial guarantees

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

Financial guarantees are initially recognised at fair value on the date the guarantee is issued. The guarantee liability is subsequently measured at the higher of the initial measurement, less amortisation to recognise the fee income earned over the period, 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.

### 2.13 Post retirement benefits

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

## 2. ACCOUNTING POLICIES (continued)

### 2.13 Post retirement benefits (continued)

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.

### 2.14 Taxation

**a) Current tax**

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

**b) Deferred tax**

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

### 2.15 Cash and cash equivalents

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

### 2.16 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.

### 2.17 Fiduciary activities

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

### 2.18 Dividends

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

### 2.19 Comparatives

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

### 2.20 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 2008.

## 2. ACCOUNTING POLICIES (continued)

### 2.20 Future accounting developments (continued)

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

- IAS 1 - Presentation of Financial Statements. A revision to IAS 1 becomes effective for financial years beginning on or after 1st January 2009. The adoption of this revision will result in changes in the presentation of the consolidated financial statements and is not expected to have any impact on the financial position of the Group.
- IFRS 8 - Operating Segments. IFRS 8 becomes effective for financial years beginning on or after 1st January 2009. This standard replaces IAS 14 - Segment Reporting and prescribes disclosure requirements in relation to the Group's operating segments, products, services and geographical areas in which it operates. The adoption of this standard is not expected to have any material impact on the consolidated financial statements.
- IAS 39 - Financial Instruments: Recognition and Measurement - Eligible Hedged Items. The amendment to IAS 39 becomes effective, with retrospective application, for financial years beginning on or after 1st January 2010. The amendment to IAS 39 clarifies the application of existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The adoption of this amendment is not expected to have any material impact on the consolidated financial statements.

## 3. ACCOUNTING ESTIMATES AND ASSUMPTIONS

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

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

### Provisions for impairment

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

In determining provisions for impairment, judgement is required in the estimation of the amount and timing of future cash flows.

In addition to provisions for impairment against specific assets, the Group also maintains provisions that are measured and recognised on a collective basis. Key assumptions included in the measurement of the portfolio provisions include data on the probability of default and the eventual recovery amount in the event of a forced sale or write off. These assumptions are based on observed historical data and updated as considered appropriate to reflect current conditions. The accuracy of the portfolio provisions would therefore be affected by unexpected changes in these assumptions.

Equity securities classified as available-for-sale are considered to be impaired when there has been a significant or prolonged decline in fair value below cost. The determination of significant or prolonged requires judgement. In making the judgement, a number of factors are taken into account including the normal volatility in valuation, evidence of a deterioration in the financial condition of the investee, industry and sector performance, and operational and financing cash flows.

### Fair value of financial assets and liabilities

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

### Retirement benefit obligations

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

## 4. CLASSIFICATION OF ASSETS AND LIABILITIES

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

| | Held-to-maturity US$ millions | Loans and receivables US$ millions | Held-for-trading US$ millions | Available-for-sale US$ millions | Financial liabilities at amortised cost US$ millions | Non-financial assets & liabilities US$ millions | Total US$ millions |
|---|---|---|---|---|---|---|---|
| **At 31st December 2008** | | | | | | | |
| Cash and other liquid assets | **1.0** | **302.0** | **-** | **-** | **-** | **-** | **303.0** |
| Placements with banks | **4,037.4** | **-** | **-** | **-** | **-** | **-** | **4,037.4** |
| Due from shareholders | **-** | **4,832.0** | **-** | **-** | **-** | **-** | **4,832.0** |
| Trading securities | **-** | **-** | **207.1** | **-** | **-** | **-** | **207.1** |
| Investment securities | **-** | **-** | **-** | **2,220.5** | **-** | **-** | **2,220.5** |
| Loans and advances | **-** | **12,972.1** | **-** | **-** | **-** | **-** | **12,972.1** |
| Other assets | **-** | **300.5** | **116.7** | **-** | **-** | **44.2** | **461.4** |
| **Total assets** | **4,038.4** | **18,406.6** | **323.8** | **2,220.5** | **-** | **44.2** | **25,033.5** |
| Deposits from banks | **-** | **-** | **-** | **-** | **3,385.9** | **-** | **3,385.9** |
| Deposits from customers | **-** | **-** | **-** | **-** | **15,009.1** | **-** | **15,009.1** |
| Securities sold under agreements to repurchase | **-** | **-** | **-** | **-** | **1,244.8** | **-** | **1,244.8** |
| Other liabilities | **-** | **-** | **158.9** | **-** | **-** | **327.8** | **486.7** |
| Senior term financing | **-** | **-** | **-** | **-** | **2,431.5** | **-** | **2,431.5** |
| Subordinated term financing | **-** | **-** | **-** | **-** | **550.0** | **-** | **550.0** |
| Equity | **-** | **-** | **-** | **-** | **-** | **1,925.5** | **1,925.5** |
| **Total liabilities & equity** | **-** | **-** | **158.9** | **-** | **22,621.3** | **2,253.3** | **25,033.5** |
| **At 31st December 2007** | | | | | | | |
| Cash and other liquid assets | 359.9 | 172.8 | - | - | - | - | 532.7 |
| Due from brokers | - | 243.3 | - | - | - | - | 243.3 |
| Placements with banks | 5,629.1 | - | - | - | - | - | 5,629.1 |
| Trading securities | - | - | 1,342.6 | - | - | - | 1,342.6 |
| Investment securities | - | - | - | 8,070.7 | - | - | 8,070.7 |
| Loans and advances | - | 12,578.6 | 23.2 | - | - | - | 12,601.8 |
| Other assets | - | 1,442.6 | 46.3 | - | - | 44.9 | 1,533.8 |
| **Total assets** | 5989.0 | 14,437.3 | 1,412.1 | 8,070.7 | - | 44.9 | 29,954.0 |
| Deposits from banks | - | - | - | - | 5,970.7 | - | 5,970.7 |
| Deposits from customers | - | - | - | - | 13,674.0 | - | 13,674.0 |
| Securities sold under agreements to repurchase | - | - | - | - | 4,141.5 | - | 4,141.5 |
| Securities sold but not yet purchased | - | - | 233.2 | - | - | - | 233.2 |
| Other liabilities | - | - | 85.5 | - | - | 426.0 | 511.5 |
| Senior term financing | - | - | - | - | 2,657.8 | - | 2,657.8 |
| Subordinated term financing | - | - | - | - | 550.0 | - | 550.0 |
| Equity | - | - | - | - | - | 2,215.3 | 2,215.3 |
| **Total liabilities & equity** | - | - | 318.7 | - | 26,994.0 | 2,641.3 | 29,954.0 |

The held-for-trading category includes the fair values of derivatives designated as fair value and cash flow hedges.

The Group did not have any financial assets or financial liabilities classified as fair value through the statement of income, other than those classified as held-for-trading, at either 31st December 2008 or 31st December 2007.

## 5. CASH AND OTHER LIQUID ASSETS

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Cash and balances with banks | **302.0** | 172.8 |
| Certificates of deposit | **1.0** | 186.2 |
| Treasury bills | **-** | 173.7 |
| | **303.0** | 532.7 |

## 6. PLACEMENTS WITH BANKS

Placements with banks at 31st December 2008 included placements with non-bank financial institutions amounting to US$45.0 million (2007: US$18.3 million).

## 7. DUE FROM SHAREHOLDERS

Based on an agreement effective 31st December 2008, the Group sold, without recourse, a significant portion of its investment securities portfolio to Bank's shareholders. The securities were sold at their amortised cost less specific provisions for impairment as at the effective date of the sale. Accordingly, no profit or loss was recorded on the transaction.

The total amortised cost less specific provisions for impairment of the sold securities at the effective date of sale on 31st December 2008, based on rates of exchange prevailing on that date, was US$4,832.0 million. This was net of specific provisions for impairment of US$544.7 million. As reported in note 9(b), the specific provisions relating to the sold securities were written off. The settlement date for the sale of the securities is 27th March 2009. The receivable due from shareholders in respect of the sale of the securities based on rates of exchange prevailing at 31st December 2008 is separately disclosed in the consolidated balance sheet.

The securities sold to shareholders comprised the Bank's entire exposure to collateralised debt obligations and other asset backed securities other than those sold or maturing prior to the settlement date of the transaction, investments in non-GCC financial institution subordinated debt, and impaired financial institution senior debt. Following the sale, the Group had no exposure, net of specific provisions, to collateralised debt obligations or other asset backed securities.

This transaction protects the Group from any future losses from these securities, materially derisks and delevers the balance sheet, reduces risk-weighted assets thereby increasing the regulatory capital adequacy ratio, and eliminates the funding risks of the assets.

## 8. TRADING SECURITIES

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Managed funds | **207.0** | 421.4 |
| Equities | **0.1** | 20.0 |
| Government bonds and bills | **-** | 278.2 |
| Listed debt securities | **-** | 623.0 |
| | **207.1** | 1,342.6 |

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

## 9. INVESTMENT SECURITIES

### a) Composition

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

| | **31.12.08** | | 31.12.07 | |
|---|---|---|---|---|
| | **US$ millions** | **%** | US$ millions | % |
| Non-impaired securities: | | | | |
| AAA to A- / Aaa to A3 | **1,690.4** | **84.1** | 6,657.4 | 87.9 |
| BBB+ to BBB- / Baa1 to Baa3 | **256.4** | **12.7** | 766.2 | 9.9 |
| Other debt securities | **64.4** | **3.2** | 156.1 | 2.2 |
| Total non-impaired debt securities | **2,011.2** | **100.0** | 7,579.7 | 100.0 |
| Equity investments | **182.0** | | 218.6 | |
| Structured finance investments | **-** | | 80.0 | |
| Impaired securities | **27.3** | | 192.4 | |
| | **2,220.5** | | 8,070.7 | |

Investment securities at 31st December 2008 principally comprised investment-grade rated debt securities issued by major international financial institutions and government-related entities.

At 31st December 2008, 84.1 per cent of non-impaired debt securities were rated A- / A3 or above (2007: 87.9 per cent).

Details of impaired investment securities are set out in note 9(c).

On 31st December 2008, a significant portion of the Group's investment securities portfolio was sold to shareholders of the Bank. The securities were sold at their amortised cost less specific provisions for impairment as at the effective date of sale. Accordingly, the sale of the securities had no impact on the consolidated statement of income for the year ended 31st December 2008. The transaction is described in more detail in note 7.

At 1st October 2008, and in accordance with the amendments to IAS 39 - Financial Instruments: Recognition and Measurement, a number of externally managed funds that are no longer held for the purpose of sale in the short term were reclassified from held-for-trading to available-for-sale. Due to the adverse impact of the credit crisis, which is considered to meet the IAS39 amendment definition of a rare event, the managed funds are closed to redemptions for the foreseeable future. The funds were reclassified at their net asset values on the date of transfer on 1st October 2008. The movements in the carrying amount of the reclassified funds were as follows:-

| | **Carrying amount US$ millions** |
|---|---|
| At 1st October 2008 | **60.8** |
| Provisions for impairment | **(37.7)** |
| Net movement in fair value | **4.2** |
| At 31st December 2008 | **27.3** |

Subsequent to the date of transfer on 1st October 2008, no amounts were recognised in income, other than provisions for impairment.

## 9. INVESTMENT SECURITIES (continued)

### b) Provisions for impairment

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

| | **2008** **US$ millions** | 2007 US$ millions |
|---|---|---|
| At 1st January | **985.0** | 63.9 |
| Exchange rate movements | **-** | 0.4 |
| Amounts utilised | **(573.6)** | (45.0) |
| Charge for the year | **365.1** | 965.7 |
| At 31st December | **776.5** | 985.0 |

Amounts utilised during the year ended 31st December 2008 of US$573.6 million (2007: US$45.0 million) represented provisions utilised on the sale or write off of the related securities. US$544.7 million related to the sale of securities to shareholders of the Bank as described in more detail in note 7.

### c) Impaired securities

Impaired securities represent securities for which there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the security.

Impaired investment securities and the related specific provisions for impairment were as follows:-

| | | **31.12.08** | | | 31.12.07 | |
|---|---|---|---|---|---|---|
| | **Gross US$ millions** | **Impairment provisions US$ millions** | **Carrying amount US$ millions** | Gross US$ millions | Impairment provisions US$ millions | Carrying amount US$ millions |
| Structured investment vehicles (SIVs) | **564.5** | **564.5** | **-** | 501.8 | 500.0 | 1.8 |
| Equity investments | **95.8** | **68.5** | **27.3** | 26.8 | 24.1 | 2.7 |
| Residential mortgage-backed CDOs | **9.5** | **9.5** | **-** | 241.8 | 135.8 | 106.0 |
| Other CDOs | **-** | **-** | **-** | 136.1 | 71.1 | 65.0 |
| Financial institutions | **-** | **-** | **-** | 18.9 | 2.0 | 16.9 |
| | **669.8** | **642.5** | **27.3** | 925.4 | 733.0 | 192.4 |
| Non-specific / portfolio provisions | | **134.0** | | | 252.0 | |
| Total provisions for impairment | | **776.5** | | | 985.0 | |

Total specific provisions for impairment at 31st December 2008 represented 95.9 per cent of gross impaired investment securities (2007: 79.2 per cent).

The impaired investment securities in the table above include past due debt securities as set out in note 9(d).

## 9. INVESTMENT SECURITIES (continued)

### d) Past due debt securities

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

| | **31.12.08** | | 31.12.07 | |
|---|---|---|---|---|
| | **Gross US$ millions** | **Carrying amount US$ millions** | Gross US$ millions | Carrying amount US$ millions |
| Residential mortgage-backed CDOs | **9.5** | - | 25.7 | 10.2 |
| Other CDOs | - | - | 15.0 | 2.0 |
| | **9.5** | - | 40.7 | 12.2 |

The past due debt securities were past due in relation to interest only and had not yet reached their contractual maturity dates.

At 31st December 2008 uncollected interest-in-suspense on past due debt securities amounted to US$0.6 million (2007: US$0.9 million).

### e) Unquoted equity investments

Investment securities at 31st December 2008 included US$130.8 million (2007: US$107.2 million) of unquoted equity investments for which fair values cannot be reliably measured. These investments are stated at cost less provision for impairment. They principally represent private equity investments and 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.

## 10. LOANS AND ADVANCES

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Gross loans and advances | **13,246.3** | 12,677.2 |
| Provisions for impairment | **(274.2)** | (75.4) |
| Net loans and advances | **12,972.1** | 12,601.8 |

## 10. LOANS AND ADVANCES (continued)

### a) Industrial classification

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

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Energy, oil and petrochemical | **3,352.2** | 3,418.4 |
| Financial services | **2,260.7** | 1,956.3 |
| Trading and services | **2,231.6** | 2,149.5 |
| Construction | **1,093.9** | 1,106.9 |
| Manufacturing | **1,154.4** | 1,012.7 |
| Transportation | **936.0** | 780.0 |
| Real estate | **845.1** | 614.2 |
| Communication | **616.8** | 616.5 |
| Government | **450.8** | 686.1 |
| Other | **304.8** | 336.6 |
| | **13,246.3** | 12,677.2 |
| Provisions for impairment | **(274.2)** | (75.4) |
| | **12,972.1** | 12,601.8 |

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.

### b) Provisions for impairment

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

| | **2008** | | | 2007 | | |
|---|---|---|---|---|---|---|
| | **Specific US$ millions** | **Non-Specific US$ millions** | **Total US$ millions** | Specific US$ millions | Non-Specific US$ millions | Total US$ millions |
| At 1st January | **10.4** | **65.0** | **75.4** | 22.9 | 60.1 | 83.0 |
| Exchange rate movements | **-** | **-** | **-** | (0.2) | - | (0.2) |
| Amounts utilised | **(2.9)** | **-** | **(2.9)** | (0.5) | - | (0.5) |
| Charge / (release) for the year | **86.7** | **115.0** | **201.7** | (11.8) | 4.9 | (6.9) |
| At 31st December | **94.2** | **180.0** | **274.2** | 10.4 | 65.0 | 75.4 |

Total provisions at 31st December 2008 exceeded the gross book value of past due loans by US$268.2 million (2007: US$58.4 million).

The increase in non-specific loan provisions during the year ended 31st December 2008 reflected increases in the expected probabilities of default used in the calculation of provisions for impairment measured on a collective basis. Higher probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment. The probabilities of default applied in the calculation of the collective provisions of impairment at 31st December 2008 equated to a speculative-grade mean default rate of 13.9 per cent, exceeding the previous historical high corporate default levels witnessed in July 1991.

Amounts utilised during the year ended 31st December 2008 of US$2.9 million (2007: US$0.5 million) represented provisions utilised on the settlement of the related loans.

## 10. LOANS AND ADVANCES (continued)

### c) Past due loans

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

| | **31.12.08** | | 31.12.07 | |
|---|---|---|---|---|
| | **Gross US$ millions** | **Carrying amount US$ millions** | Gross US$ millions | Carrying amount US$ millions |
| Corporates | **4.0** | **-** | 11.8 | - |
| Financial institutions | **2.0** | **1.0** | 5.2 | 2.6 |
| | **6.0** | **1.0** | 17.0 | 2.6 |

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

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Less than 1 year | **-** | 4.0 |
| 2 to 5 years | **6.0** | 13.0 |
| | **6.0** | 17.0 |

At 31st December 2008 uncollected interest-in-suspense on past due loans amounted to US$0.4 million (2007: US$2.3 million).

### d) Renegotiated loans

There were no renegotiated loans during either the year ended 31st December 2008 or 31st December 2007.

### e) Collateral

The Group did not take possession of any collateral as a result of a loan default during either the year ended 31st December 2008 or 31st December 2007.

## 11. OTHER ASSETS

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Accrued interest, fees and commissions | **235.4** | 345.0 |
| Derivative financial instruments | **113.5** | 46.3 |
| Premises and equipment | **44.2** | 44.9 |
| Prepaid pension cost | **16.2** | 14.6 |
| Prepayments | **8.7** | 6.5 |
| Deferred items | **6.2** | 9.6 |
| Amounts receivable in respect of increase in share capital | **-** | 1,000.0 |
| Outstanding security settlements | **-** | 1.0 |
| Other, including accounts receivable | **37.2** | 65.9 |
| | **461.4** | 1,533.8 |

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 30(d).

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

The amounts receivable in respect of the increase in share capital are commented on in more detail in note 18.

## 12. POST RETIREMENT BENEFITS

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

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31st December 2008 amounted to US$6.3 million (2007: US$5.8 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit pension plan for a large number of 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 2007.

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

| | **31.12.08 US$ millions** | 31.12.07 US$ millions |
|---|---|---|
| Fair value of plan assets | **117.5** | 169.9 |
| Present value of fund obligations | **101.5** | 162.5 |
| Plan surplus | **16.0** | 7.4 |
| Unrecognised actuarial loss | **0.2** | 7.2 |
| Net asset in the consolidated balance sheet | **16.2** | 14.6 |

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

| | **2008 US$ millions** | 2007 US$ millions |
|---|---|---|
| At 1st January | **169.9** | 132.5 |
| Expected return on plan assets | **10.9** | 9.2 |
| Contributions paid by the Group | **2.9** | 23.5 |
| Benefits paid by the plan | **(2.7)** | (2.3) |
| Actuarial (losses) / gains | **(19.3)** | 3.4 |
| Exchange rate movements | **(44.2)** | 3.6 |
| At 31st December | **117.5** | 169.9 |

The plan assets at 31st December 2008 comprise equity and debt securities in the ratio of 23 per cent and 77 per cent respectively (2007: 35 per cent and 65 per cent respectively). Cash holdings within the plan assets are included in debt securities.

The expected and actual returns on the plan assets for the year ended 31st December 2008 were US$10.9 million and US$(8.8) million respectively (2007: US$9.2 million and US$12.6 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.

## 12. POST RETIREMENT BENEFITS (continued)

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

| | 2008 US$ millions | 2007 US$ millions |
|---|---|---|
| At 1st January | **162.5** | 161.7 |
| Current service cost | **2.2** | 2.8 |
| Interest cost | **9.4** | 8.4 |
| Actuarial gains | **(31.7)** | (11.5) |
| Benefits paid by the plan | **(2.7)** | (2.3) |
| Exchange rate movements | **(38.2)** | 3.4 |
| At 31st December | **101.5** | 162.5 |

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

| | 2008 US$ millions | 2007 US$ millions |
|---|---|---|
| At 1st January | **14.6** | (7.3) |
| Net expense included in staff expenses | **(0.9)** | (2.8) |
| Contributions paid by the Group | **2.9** | 23.5 |
| Exchange rate movements | **(0.4)** | 1.2 |
| At 31st December | **16.2** | 14.6 |

The Group paid US$2.9 million in contributions to the plan during 2008 and expects to pay US$1.7 million during 2009.

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

| | 2008 US$ millions | 2007 US$ millions |
|---|---|---|
| Current service cost | **2.2** | 2.8 |
| Interest cost | **9.4** | 8.4 |
| Expected return on plan assets | **(10.9)** | (9.2) |
| Amortisation of actuarial loss | **0.1** | 0.8 |
| Losses on curtailments and settlements | **0.1** | - |
| Net expense included in staff expenses | **0.9** | 2.8 |

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

| | 2008 | 2007 |
|---|---|---|
| Discount rate | **6.4%** | 5.8% |
| Expected return on plan assets - equities | **8.0%** | 8.0% |
| Expected return on plan assets - bonds | **5.8%** | 5.8% |
| Future salary increases | **4.2%** | 4.5% |
| Future increases to pensions in payment | **3.0%** | 2.4% |

## 12. POST RETIREMENT BENEFITS (continued)

### g) Historical information

| | **2008** US$ millions | 2007 US$ millions | 2006 US$ millions | 2005 US$ millions | 2004 US$ millions |
|---|---|---|---|---|---|
| Fair value of plan assets | **117.5** | 169.9 | 132.5 | 105.9 | 100.0 |
| Present value of fund obligations | **101.5** | 162.5 | 161.7 | 138.1 | 134.4 |
| Plan surplus / (deficit) | **16.0** | 7.4 | (29.2) | (32.2) | (34.4) |
| Experience gains on plan assets | **3.2** | 4.2 | 3.5 | 10.4 | 11.0 |
| Experience (losses) / gains on plan liabilities | **(14.6)** | (1.2) | 0.3 | 5.0 | (3.0) |

## 13. DEPOSITS

Deposits from customers include deposits from central banks.

The geographical composition of total deposits was as follows:-

| | **31.12.08** US$ millions | 31.12.07 US$ millions |
|---|---|---|
| GCC countries | **12,223.4** | 12,636.7 |
| Other Middle East and North Africa countries | **4,213.9** | 4,931.7 |
| Other countries | **1,957.7** | 2,076.3 |
| | **18,395.0** | 19,644.7 |

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

GCC deposits at 31st December 2008 represented 66.4 per cent (2007: 64.3 per cent) of total deposits.

Total deposits at 31st December 2008 included Islamic-related transactions amounting to US$1,086.0 million (2007: US$2,463.7 million). Islamic-related transactions comprised Murabaha contracts.

## 14. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the investment securities and trading portfolios. At 31st December 2008, the fair value of investment and trading securities that had been pledged as collateral under repurchase agreements was US$1,687.0 million and nil respectively (2007: US$4,033.5 million and US$28.3 million respectively). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

At 31st December 2008, the fair value of investment securities that had been pledged as collateral under the term repo facility referred to in note 16 was US$106.1 million (2007: US$344.4 million). This was in addition to the investment securities pledged as collateral under repurchase agreements referred to above.

## 15. OTHER LIABILITIES

| | 31.12.08 US$ millions | 31.12.07 US$ millions |
|---|---|---|
| Accrued interest | **183.1** | 260.3 |
| Derivative financial instruments | **158.9** | 85.5 |
| Deferred items | **75.4** | 80.4 |
| Minority interests | **-** | 11.0 |
| Other, including accounts payable and accrued expenses | **69.3** | 74.3 |
| | **486.7** | 511.5 |

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 30(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.

## 16. SENIOR TERM FINANCING

| | Maturity | 31.12.08 US$ millions | 31.12.07 US$ millions |
|---|---|---|---|
| Floating rate repo | 2008-2009 | **100.0** | 300.0 |
| Floating rate loans | 2009 | **177.9** | 175.0 |
| Islamic Murabaha term facilities | 2009 | **29.0** | 29.0 |
| Floating rate loans | 2010 | **850.0** | 800.0 |
| Islamic Murabaha term facility | 2010 | **14.6** | 14.6 |
| Floating rate loan | 2011 | **60.0** | 60.0 |
| Floating rate loans | 2012 | **1,200.0** | 1,273.1 |
| Islamic Murabaha term facility | 2008 | **-** | 6.1 |
| | | **2,431.5** | 2,657.8 |

## 17. SUBORDINATED TERM FINANCING

| | Maturity | 31.12.08 US$ millions | 31.12.07 US$ millions |
|---|---|---|---|
| Floating rate note | 2015 | **400.0** | 400.0 |
| Floating rate loans | 2016 | **150.0** | 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.

## 18. SHARE CAPITAL

The authorised share capital at 31st December 2008 comprised 3.0 billion shares of US$1 each (2007: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2008 comprised 2.5 billion shares of US$1 each (2007: 1.5 billion shares of US$1 each). All issued shares are fully paid.

At an Extraordinary General Assembly meeting held on 20th February 2008, the shareholders ratified an earlier commitment in 2007 to increase the issued share capital of the Bank by US$1.0 billion to US$2.5 billion. The proceeds of the capital increase were received in March 2008. The capital increase was classified as a proposed increase in share capital pending the completion of the relevant legal formalities. The legal formalities were completed on 10th September 2008, following which the proposed increase in share capital was transferred to share capital.

## 19. 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 2007** | **169.2** | **106.7** | **(1.2)** | **91.2** | **365.9** |
| Arising in the year:- | | | | | |
| - Available-for-sale securities: net fair value losses | - | - | - | (248.8) | (248.8) |
| - Cash flow hedges: net fair value gains | - | - | 1.3 | - | 1.3 |
| Transfers in the year:- | | | | | |
| - Transfers to statement of income | - | - | 1.0 | (9.8) | (8.8) |
| Net gains / (losses) recognised directly in equity | - | - | 2.3 | (258.6) | (256.3) |
| **At 31st December 2007** | **169.2** | **106.7** | **1.1** | **(167.4)** | **109.6** |
| Arising in the year:- | | | | | |
| - Available-for-sale securities: net fair value gains | - | - | - | 8.2 | 8.2 |
| - Cash flow hedges: net fair value gains | - | - | 10.5 | - | 10.5 |
| Transfers in the year:- | | | | | |
| - Transfers to statement of income | - | - | (4.4) | 92.1 | 87.7 |
| Net gains recognised directly in equity | - | - | 6.1 | 100.3 | 106.4 |
| **At 31st December 2008** | **169.2** | **106.7** | **7.2** | **(67.1)** | **216.0** |

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. No transfers were made to the compulsory or voluntary reserve for either the year ended 31st December 2008 or 31st December 2007.

## 20. DIVIDENDS

No dividend is proposed in respect of the financial year ended 31st December 2008.

## 21. NET INTEREST INCOME

| | 2008 US$ millions | 2007 US$ millions |
|---|---|---|
| **Interest income** | | |
| Placements and other liquid assets | **221.2** | 306.9 |
| Due from brokers | **0.8** | 29.3 |
| Investment securities | **370.4** | 494.1 |
| Loans and advances | **629.6** | 682.4 |
| Total interest income | **1,222.0** | 1,512.7 |
| **Interest expense** | | |
| Deposits from banks and customers | **662.6** | 911.9 |
| Securities sold under agreements to repurchase | **152.1** | 127.9 |
| Term financing | **119.0** | 167.3 |
| Total interest expense | **933.7** | 1,207.1 |
| **Net interest income** | **288.3** | 305.6 |

Interest income on investment securities includes dividends received from structured finance investments.

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

Accrued but uncollected interest on impaired loans included in interest income for the year ended 31st December 2008 amounted to US$1.1 million (2007: nil). There was no accrued but uncollected interest included in interest income on past due loans or past due investment securities for either the year ended 31st December 2008 or 31st December 2007.

## 22. FEE AND COMMISSION INCOME

| | 2008 US$ millions | 2007 US$ millions |
|---|---|---|
| **Fee and commission income** | | |
| Investment banking and management fees | **48.1** | 61.2 |
| Commissions on letters of credit and guarantee | **22.8** | 20.8 |
| Loan commitment fees | **3.2** | 5.0 |
| Other fee and commission income | **1.4** | 3.5 |
| Total fee and commission income | **75.5** | 90.5 |
| **Fee and commission expense** | **(2.2)** | (2.4) |
| **Net fee and commission income** | **73.3** | 88.1 |

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.

Investment banking and management fees for the year ended 31st December 2008 included fee income relating to the Group's fiduciary activities amounting to US$29.5 million (2007: US$35.3 million).

Fee and commission expense principally comprises security custody fees.

## 23. NET TRADING LOSS

| | **2008** US$ millions | 2007 US$ millions |
|---|---|---|
| Foreign exchange | **16.1** | 9.7 |
| Interest rate derivatives | **3.3** | 1.4 |
| Loans held for trading | **0.2** | 0.1 |
| Equity securities | **(10.0)** | (2.0) |
| Debt securities | **(30.5)** | (91.5) |
| Managed funds | **(65.8)** | (4.3) |
| | **(86.7)** | (86.6) |

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.

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

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

The loss on debt securities for the year ended 31st December 2008 included a loss of US$28.4 million arising on the liquidation of the Group's asset backed security proprietary trading portfolio. The portfolio was entirely liquidated during the three months ended 31st March 2008.

The loss on managed funds for the year ended 31st December 2008 largely arose on alternative investment (hedge) funds. At 31st December 2008, the Group's alternative investment funds classified as held-for-trading amounted to US$152.8 million (2007: US$333.9 million).

An analysis of the basis used for determining the fair values of held-for-trading financial assets and liabilities is set out in note 36.

## 24. OTHER INCOME

Other income principally comprises profits realised on the sale of premises and equipment, dividends on available-for-sale equity investments, and loan recoveries.

## 25. 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.

## 25. SEGMENTAL INFORMATION (continued)

### a) Business segments (continued)

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 these consolidated financial statements and are set out in note 2. Transactions between business segments are conducted on normal commercial terms and conditions. Transfer pricing between the business units is based on the market cost of funds.

Segment results, assets and liabilities comprise items directly attributable to the business segments. 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.

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 |
|---|---|---|---|---|---|
| **2008** | | | | | |
| Total income | **202.4** | **(7.9)** | **(2.2)** | **130.4** | **322.7** |
| Segment result | **(33.6)** | **(364.4)** | **(27.7)** | **134.3** | **(291.4)** |
| Unallocated overhead | | | | | **(95.6)** |
| Taxation charge on overseas activities | | | | | **(9.2)** |
| Net loss after tax | | | | | **(396.2)** |
| Segment assets | **13,519.8** | **11,382.6** | **50.7** | **80.4** | **25,033.5** |
| Segment liabilities | **-** | **20,597.4** | **27.5** | **2,483.1** | **23,108.0** |
| Total equity | | | | | **1,925.5** |
| Total liabilities and equity | | | | | **25,033.5** |
| **2007** | | | | | |
| Total income | 173.8 | 118.1 | (58.8) | 109.3 | 342.4 |
| Segment result | 168.0 | (857.9) | (77.1) | 103.3 | (663.7) |
| Unallocated overhead | | | | | (93.9) |
| Taxation credit on overseas activities | | | | | 0.3 |
| Net loss after tax | | | | | (757.3) |
| Segment assets | 13,065.0 | 14,558.7 | 1,235.7 | 1,094.6 | 29,954.0 |
| Segment liabilities | 14.2 | 24,727.8 | 35.1 | 2,961.6 | 27,738.7 |
| Total equity | | | | | 2,215.3 |
| Total liabilities and equity | | | | | 29,954.0 |

For the year ended 31st December 2008

## 25. SEGMENTAL INFORMATION (continued)

### 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:-

| | **2008 US$ millions** | 2007 US$ millions |
|---|---|---|
| GCC countries | **290.8** | 359.9 |
| Other countries | **31.9** | (17.5) |
| | **322.7** | 342.4 |

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

## 26. RISK MANAGEMENT

The principal risks associated with the Group's businesses are credit risk, market risk, liquidity risk and operational risk. The Group has a comprehensive risk management framework in place for managing these risks which is constantly evolving as the business activities change in response to credit, market, product and other developments. The risk management framework is guided by a number of overriding principles including the formal definition of risk management governance, an evaluation of risk appetite expressed in terms of formal risk limits, risk oversight independent of business units, disciplined risk assessment and measurement including Value-at-Risk (VaR) methodologies and portfolio stress testing, and risk diversification. The Board of Directors set the Group's overall risk parameters and risk tolerances, and the significant risk management policies. A Board Risk Policy Committee reviews and reports to the Board of Directors on the Group's risk profile and risk taking activities. 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 Managing Director - Risk Management 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 described in detail in the Basel 2 Pillar 3 disclosure report in the Annual Report and are summarised below together with additional quantitative analysis:-

### a) 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.

## 26. RISK MANAGEMENT (continued)

### a) Credit risk (continued)

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is 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.

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

#### Maximum exposure to credit risk

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

| | **At 31.12.08 US$ millions** | At 31.12.07 US$ millions |
|---|---|---|
| **Balance sheet items:** | | |
| Cash and other liquid assets | **303.0** | 532.7 |
| Due from brokers | **-** | 243.3 |
| Placements with banks | **4,037.4** | 5,629.1 |
| Due from shareholders | **4,832.0** | - |
| Trading securities | **207.1** | 1,342.6 |
| Investment securities | **2,220.5** | 8,070.7 |
| Loans and advances | **12,972.1** | 12,601.8 |
| Other assets, excluding derivative-related items | **235.4** | 1,345.0 |
| **Total on-balance sheet credit exposure** | **24,807.5** | 29,765.2 |
| **Off-balance sheet items:** | | |
| Credit-related contingent items | **3,637.5** | 7,261.9 |
| Foreign exchange-related items | **76.0** | 60.2 |
| Derivative-related items | **123.3** | 46.1 |
| **Total off-balance sheet credit exposure** | **3,836.8** | 7,368.2 |
| **Total gross credit exposure** | **28,644.3** | 37,133.4 |

#### Credit risk profile

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits. The internal credit rating system also serves as a key input into the Group's risk-adjusted return on capital (RAROC) performance measurement system. Ratings are assigned to obligors, rather than facilities, and reflect a medium term time horizon, thereby rating through an economic cycle. The internal ratings map directly to the rating grades used by the international credit rating agencies as follows:-

## 26. RISK MANAGEMENT (continued)

### a) Credit risk (continued)

| Internal rating grade | Internal classification | Historical default rate range | External Rating Fitch and Standard & Poor's | External Rating Moody's |
|---|---|---|---|---|
| | | % | | |
| **Investment grade** | | | | |
| Rating grade 1 | Standard | 0.00 - 0.00 | AAA | Aaa |
| Rating grade 2 | Standard | 0.00 - 0.02 | AA | Aa |
| Rating grade 3 | Standard | 0.05 - 0.07 | A | A |
| Rating grade 4 | Standard | 0.15 - 0.31 | BBB | Baa |
| **Sub-investment grade** | | | | |
| Rating grade 5 | Standard | 0.52 - 1.44 | BB | Ba |
| Rating grade 6 | Standard | 2.53 - 9.06 | B | B |
| Rating grade 7 | Standard | 25.59 | CCC | Caa |
| **Classified** | | | | |
| Rating grade 8 | Substandard | 25.59 | CC | Ca |
| Rating grade 9 | Doubtful | 25.59 | C | C |
| Rating grade 10 | Loss | - | D | - |

The historical default rates represent the range of probability of defaults between the positive and negative modifiers for each rating grade based on Standard & Poor's one year default rates for the 27 years from 1981 to 2007 for senior unsecured obligations. The default rates represent the averages over the 27 year period and therefore reflect the full range of economic conditions over that period.

The credit risk profile, based on internal credit ratings, was as follows:-

| | **31.12.08** | | | 31.12.07 | | |
|---|---|---|---|---|---|---|
| | **Placements, due from shareholders & other liquid assets US$ millions** | **Securities US$ millions** | **Loans and advances US$ millions** | Placements, due from brokers & other liquid assets US$ millions | Securities US$ millions | Loans and advances US$ millions |
| **Neither past due nor impaired** | | | | | | |
| Rating grades 1 to 4- | **9,172.4** | **1,946.8** | **9,378.3** | 6,370.1 | 8,084.7 | 9,086.9 |
| Rating grades 5+ to 5- | **-** | **29.5** | **3,124.6** | 35.0 | 299.4 | 3,105.7 |
| Rating grades 6+ to 6- | **-** | **15.0** | **354.8** | - | 113.3 | 397.5 |
| Rating grade 7 | **-** | **19.9** | **6.7** | - | 26.3 | 9.1 |
| Equity investments | **-** | **389.1** | **-** | - | 697.2 | - |
| **Carrying amount** | **9,172.4** | **2,400.3** | **12,864.4** | 6,405.1 | 9,220.9 | 12,599.2 |
| **Past due or individually impaired** | | | | | | |
| Rating grades 1 to 7 | **-** | **-** | **-** | - | 171.9 | - |
| Rating grade 8 | **-** | **-** | **26.2** | - | 6.3 | - |
| Rating grade 9 | **-** | **-** | **81.5** | - | 7.8 | - |
| Rating grade 10 | **-** | **-** | **-** | - | 2.0 | 2.6 |
| Equity investments | **-** | **27.3** | **-** | - | 4.4 | - |
| **Carrying amount** | **-** | **27.3** | **107.7** | - | 192.4 | 2.6 |
| **Total** | **9,172.4** | **2,427.6** | **12,972.1** | 6,405.1 | 9,413.3 | 12,601.8 |

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

| | | | | | | |
|---|---|---|---|---|---|---|
| **Provisions for impairment** | **-** | **(776.5)** | **(274.2)** | - | (985.0) | (75.4) |

## 26. RISK MANAGEMENT (continued)

### a) Credit risk (continued)

Individually impaired financial assets represent assets for which there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the obligation.

At 31st December 2008 there were no past due but not impaired financial assets (2007: nil).

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees. The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market/fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. Collateral is not usually held against securities or placements and no such collateral was held at either 31st December 2008 or 31st December 2007.

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

#### Credit risk concentration

The Group monitors concentrations of credit risk by sector and by geographic location. The industrial classification of loans and advances is set out in note 10. The geographical distribution of risk assets is set out in note 27. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 30.

#### Settlement risk

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

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

### b) 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, credit and commodity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. It is recognised that there are limitations to the VaR methodology. These limitations include the fact that the historical data may not be the best proxy for future price movements. The Group performs regular back testing exercises to compare actual profits and losses with the VaR estimates to monitor the statistical validity of the VaR model. VaR is calculated based on the Group's market risk exposures at the close of the business each day. Intra-day risk levels may vary from those reported at the end of the day. In addition, losses beyond the specified confidence level are not captured by the VaR methodology. VaR is not a measure of the absolute limit of market risk and losses in excess of the VaR amounts will, on occasion, arise. To manage the risk associated with extreme market movements, the Group conducts stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. The composition of the debt and equity trading securities is set out in note 8. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 30.

## 26. RISK MANAGEMENT (continued)

### b) Market risk (continued)

- **Trading market risk (continued)**

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

| | 2008 | | | | 2007 | | | |
|---|---|---|---|---|---|---|---|---|
| | **31.12.08** | **Average** | **High** | **Low** | 31.12.07 | Average | High | Low |
| | **US$ millions** | **US$ millions** | **US$ millions** | **US$ millions** | US$ millions | US$ millions | US$ millions | US$ millions |
| Interest rate risk | **1.4** | **1.6** | **2.6** | **1.1** | 3.2 | 4.1 | 6.8 | 3.0 |
| Foreign exchange risk | **-** | **0.2** | **0.9** | **-** | 0.2 | 0.8 | 2.8 | 0.2 |
| Equity risk | **3.8** | **5.8** | **7.6** | **3.8** | 7.0 | 5.8 | 7.8 | 3.8 |
| Total diversified risk | **4.6** | **7.1** | **9.7** | **4.6** | 9.3 | 8.0 | 10.8 | 6.0 |

- **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 are set out in note 29. The Group is exposed to the impact of changes in credit spreads on the fair value of available-for-sale debt securities. Movements in the fair value of available-for-sale securities are accounted for in equity. Credit spread risk is managed within VaR limits and through the use of models to evaluate the sensitivity of changes in equity to movements in credit spreads. Based on the available-for-sale debt securities held at 31st December 2008, a 1 b.p. increase in credit spreads would result in a US$0.6 million decrease in fair value (2007: US$3.1 million). The Group does not maintain material non-trading equity or foreign currency exposures. In general, the Group's policy is to match financial assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in note 30(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 |

## 26. RISK MANAGEMENT (continued)

### c) Liquidity risk

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

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

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

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

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

The Group has established limits which restrict the volume of liabilities maturing in the short term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 14 day period. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

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

The maturity profile of assets and liabilities is set out in note 28. An analysis of debt investment securities by rating classification is set out in note 26 (a).

### d) Operational risk

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

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

## 26. RISK MANAGEMENT (continued)

### e) Capital management

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

As referred to in more detail in note 33, the Group adopted the Basel 2 capital adequacy framework with effect from 1st January 2008.

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. The Group calculates regulatory capital requirements for general market risk in its trading portfolios using a Value-at-Risk model and uses the CBB's prescribed risk weightings under the standardised approach to determine the risk-weighted amounts for credit risk and specific market risk. Operational risk is calculated by applying the CBB's prescribed alpha co-efficient to the Group's average gross income for the preceding three financial years.

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 equity securities classified as available-for-sale securities.
- 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 equity securities classified as available-for-sale securities.

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.

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, the issue of new shares, subordinated term finance and innovative tier 1 capital securities.

The Group and its individually regulated operations complied with all externally imposed capital requirements throughout the years ended 31st December 2008 and 31st December 2007.

Other than the adoption of the Basel 2 capital adequacy framework with effect from 1st January 2008, there have been no material changes in the Group's management of capital during the years ended 31st December 2008 and 31st December 2007.

The capital adequacy ratio calculated in accordance with the guidelines of the Basel Committee is set out in note 33.

## 27. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

| | 31.12.08 | | | | | 31.12.07 |
|---|---|---|---|---|---|---|
| | **Placements, due from shareholders & other liquid assets US$ millions** | **Securities US$ millions** | **Loans and advances US$ millions** | **Credit-related contingent items US$ millions** | **Total US$ millions** | Total US$ millions |
| GCC | **5,662.0** | **1,412.3** | **12,215.3** | **2,983.1** | **22,272.7** | 21,800.7 |
| Other Middle East & North Africa | **-** | **39.4** | **332.1** | **172.4** | **543.9** | 617.8 |
| Europe | **3,006.0** | **363.2** | **383.8** | **287.0** | **4,040.0** | 7,526.5 |
| North America | **317.6** | **577.6** | **2.2** | **193.2** | **1,090.6** | 4,980.0 |
| Asia | **186.8** | **35.1** | **38.7** | **1.8** | **262.4** | 582.9 |
| Latin America | **-** | **-** | **-** | **-** | **-** | 174.2 |
| | **9,172.4** | **2,427.6** | **12,972.1** | **3,637.5** | **28,209.6** | 35,682.1 |

At 31st December 2008, risk exposures to customers and counterparties in the GCC represented 79.0 per cent (2007: 61.1 per cent) of total risk assets. The risk asset profile reflects the Group's strategic focus on merchant banking activities in the GCC states. An analysis of derivative and foreign exchange instruments is set out in note 30.

## 28. MATURITIES OF ASSETS AND LIABILITIES

The maturity profile of the carrying amount of assets and liabilities, based on the 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 2008** | | | | | | |
| Cash and other liquid assets | **302.0** | **1.0** | **-** | **-** | **-** | **303.0** |
| Placements with banks | **4,037.4** | **-** | **-** | **-** | **-** | **4,037.4** |
| Due from shareholders | **4,832.0** | **-** | **-** | **-** | **-** | **4,832.0** |
| Trading securities | **207.1** | **-** | **-** | **-** | **-** | **207.1** |
| Investment securities | **111.4** | **223.1** | **843.3** | **365.8** | **676.9** | **2,220.5** |
| Loans and advances | **3,272.4** | **2,755.3** | **2,712.5** | **1,539.1** | **2,692.8** | **12,972.1** |
| Other assets | **322.9** | **57.8** | **10.9** | **11.5** | **58.3** | **461.4** |
| Total assets | **13,085.2** | **3,037.2** | **3,566.7** | **1,916.4** | **3,428.0** | **25,033.5** |
| Deposits | **16,897.1** | **1,478.6** | **15.4** | **3.9** | **-** | **18,395.0** |
| Securities sold under agreements to repurchase | **1,028.0** | **216.8** | **-** | **-** | **-** | **1,244.8** |
| Other liabilities | **299.0** | **52.9** | **48.7** | **51.5** | **34.6** | **486.7** |
| Term financing | **29.0** | **277.8** | **924.7** | **1,200.0** | **550.0** | **2,981.5** |
| Equity | **-** | **-** | **-** | **-** | **1,925.5** | **1,925.5** |
| Total liabilities & equity | **18,253.1** | **2,026.1** | **988.8** | **1,255.4** | **2,510.1** | **25,033.5** |
| **At 31st December 2007** | | | | | | |
| Total assets | 12,715.6 | 2,723.8 | 4,362.4 | 2,958.4 | 7,193.8 | 29,954.0 |
| Total liabilities & equity | 18,788.6 | 5,826.5 | 1,146.5 | 1,355.5 | 2,836.9 | 29,954.0 |

## 28. MATURITIES OF ASSETS AND LIABILITIES (continued)

The asset and liability maturities presented in the previous table 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 2008 for counterparties with individual deposits of US$10.0 million and above at 31st December 2008 amounted to US$13,081.2 million (2007: US$17,002.8 million). This represented 71.1 per cent of total deposits at 31st December 2008 (2007: 86.5 per cent). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

The gross cash flows payable by the Group under financial liabilities, based on 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 US$ millions |
|---|---|---|---|---|---|
| **At 31st December 2008** | | | | | |
| Deposits | **17,050.3** | **1,502.5** | **16.3** | **4.8** | **-** |
| Securities sold under agreements to repurchase | **1,044.1** | **225.3** | **-** | **-** | **-** |
| Term financing | **59.2** | **310.2** | **1,020.7** | **1,273.1** | **596.3** |
| Derivative financial instruments: | | | | | |
| - contractual amounts payable | **116.0** | **183.3** | **293.2** | **163.7** | **214.3** |
| - contractual amounts receivable | **(52.0)** | **(137.7)** | **(228.4)** | **(149.4)** | **(193.0)** |
| Total undiscounted financial liabilities | **18,217.6** | **2,083.6** | **1,101.8** | **1,292.2** | **617.6** |
| **At 31st December 2007** | | | | | |
| Deposits | 17,227.8 | 2,617.9 | 0.6 | 6.0 | - |
| Securities sold under agreements to repurchase | 1,188.3 | 3,095.1 | - | - | - |
| Term financing | 46.2 | 333.4 | 1,398.8 | 1,529.0 | 652.4 |
| Derivative financial instruments: | | | | | |
| - contractual amounts payable | 91.8 | 147.9 | 239.4 | 98.2 | 59.3 |
| - contractual amounts receivable | (73.8) | (157.5) | (219.8) | (97.7) | (55.4) |
| Total undiscounted financial liabilities | 18,480.3 | 6,036.8 | 1,419.0 | 1,535.5 | 656.3 |

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

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

Held-for-trading liabilities (securities sold but not yet purchased) have not been included in the table above as they are typically held for short periods of time.

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 30(c).

## 29. INTEREST RATE RISK

The repricing profile of assets and liabilities 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 |
|---|---|---|---|---|---|---|
| **At 31st December 2008** | | | | | | |
| Cash and other liquid assets | 302.0 | 1.0 | - | - | - | 303.0 |
| Placements with banks | 3,662.4 | 75.0 | - | 300.0 | - | 4,037.4 |
| Due from shareholders | 4,832.0 | - | - | - | - | 4,832.0 |
| Trading securities | - | - | - | - | 207.1 | 207.1 |
| Investment securities:- | | | | | | |
| - Fixed rate | 20.0 | 13.4 | 13.5 | 154.5 | - | 201.4 |
| - Floating rate | 1,784.5 | 159.3 | - | - | (134.0) | 1,809.8 |
| - Equities & equity funds | - | - | - | - | 209.3 | 209.3 |
| Loans and advances | 10,610.3 | 2,371.2 | 144.6 | 26.0 | (180.0) | 12,972.1 |
| Other assets | - | - | - | - | 461.4 | 461.4 |
| Total assets | 21,211.2 | 2,619.9 | 158.1 | 480.5 | 563.8 | 25,033.5 |
| Deposits | 17,301.0 | 927.1 | 153.2 | 13.7 | - | 18,395.0 |
| Securities sold under agreements to repurchase | 1,028.0 | 216.8 | - | - | - | 1,244.8 |
| Other liabilities | - | - | - | - | 486.7 | 486.7 |
| Term financing | 2951.5 | 30.0 | - | - | - | 2,981.5 |
| Equity | - | - | - | - | 1,925.5 | 1,925.5 |
| Total liabilities & equity | 21,280.5 | 1,173.9 | 153.2 | 13.7 | 2,412.2 | 25,033.5 |
| **Interest rate sensitivity gap** | (69.3) | 1,446.0 | 4.9 | 466.8 | (1,848.4) | - |
| **Cumulative interest rate sensitivity gap** | (69.3) | 1,376.7 | 1,381.6 | 1,848.4 | - | - |
| **At 31st December 2007** | | | | | | |
| Cumulative interest rate sensitivity gap | (748.1) | 688.5 | 68.9 | 513.6 | - | - |

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 provisions are 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 2008 the modified duration of these fixed rate securities and interest rate swaps was 3.03. 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$140,500.

Based on the repricing profile at 31st December 2008, 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$7.0 million and US$22.1 million respectively (2007: US$7.7 million and US$28.6 million respectively). The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

The Value-at-Risk by risk class for the Group's trading positions is set out in note 26. The market risk relating to foreign exchange and derivative trading instruments is set out in note 30.

## 30. 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, credit and commodity markets. Derivatives and foreign exchange are subject to the same types of credit and market risk as other financial instruments. The Group has appropriate and comprehensive Board-approved policies and procedures for the control of exposure to both market and credit risk from its derivative and foreign exchange activities.

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

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

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

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

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

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

The Group also transacts in other derivative products including total return swaps used to hedge trading transactions.

## 30. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

### a) Product analysis

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

| | Notional amounts Trading US$ millions | Hedging US$ millions | Total US$ millions | Credit risk amounts US$ millions |
|---|---|---|---|---|
| **At 31st December 2008** | | | | |
| Foreign exchange contracts:- | | | | |
| Unmatured spot, forward and futures contracts | **1,570.2** | **2,741.5** | **4,311.7** | **76.0** |
| Options purchased | **13.8** | **-** | **13.8** | **-** |
| Options written | **13.8** | **-** | **13.8** | **-** |
| | **1,597.8** | **2,741.5** | **4,339.3** | **76.0** |
| Interest rate contracts:- | | | | |
| Interest rate swaps and swaptions | **2,261.8** | **2,882.1** | **5,143.9** | **123.1** |
| Options, caps and floors purchased | **24.3** | **-** | **24.3** | **0.2** |
| Options, caps and floors written | **24.3** | **-** | **24.3** | **-** |
| | **2,310.4** | **2,882.1** | **5,192.5** | **123.3** |
| Credit contracts:- | | | | |
| Protection sold | **159.0** | **-** | **159.0** | **-** |
| Other contracts:- | | | | |
| Total return swaps | **20.0** | **-** | **20.0** | **-** |
| **Total** | **4,087.2** | **5,623.6** | **9,710.8** | **199.3** |
| **At 31st December 2007** | | | | |
| Total | 5,135.5 | 8,793.3 | 13,928.8 | 106.3 |

There is no credit risk in respect of options, caps and floors written, and protection sold on credit contracts as they represent obligations of the Group.

At 31st December 2008 the Value-at-Risk of the foreign exchange, interest rate, credit, and other derivative trading contracts analysed in the table above, as calculated in accordance with the basis set out in note 33, was US$0.2 million, US$0.2 million, US$1.1 million and US$1.0 million respectively (2007: US$0.2 million, US$0.2 million, US$1.1 million and nil respectively). Value-at-Risk is a measure of market risk exposure and is accordingly separate and in addition to the credit risk exposure represented by the credit risk amounts in the table above.

### b) Counterparty analysis

| | 31.12.08 Banks US$ millions | Other US$ millions | Total US$ millions | 31.12.07 Total US$ millions |
|---|---|---|---|---|
| **Credit risk amounts** | | | | |
| OECD countries | **100.1** | **-** | **100.1** | 71.0 |
| GCC countries | **2.5** | **96.3** | **98.8** | 34.8 |
| Other countries | **0.1** | **0.3** | **0.4** | 0.5 |
| | **102.7** | **96.6** | **199.3** | 106.3 |

Credit risk is concentrated on major OECD-based banks and GCC-related customers.

## 30. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

### c) Maturity analysis

| | Year 1 US$ millions | Years 2 & 3 US$ millions | Years 4 & 5 US$ millions | Over 5 years US$ millions | Total US$ millions |
|---|---|---|---|---|---|
| **At 31st December 2008** | | | | | |
| Foreign exchange contracts | **4,339.3** | **-** | **-** | **-** | **4,339.3** |
| Interest rate contracts | **1,973.9** | **1,088.5** | **876.7** | **1,253.4** | **5,192.5** |
| Credit contracts | **60.0** | **-** | **95.0** | **4.0** | **159.0** |
| Other contracts | **20.0** | **-** | **-** | **-** | **20.0** |
| **Total** | **6,393.2** | **1,088.5** | **971.7** | **1,257.4** | **9,710.8** |
| **At 31st December 2007** | | | | | |
| Total | 9,418.1 | 1,713.4 | 1,131.5 | 1,665.8 | 13,928.8 |

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.

### d) Fair value analysis

| | **31.12.08** | | 31.12.07 | |
|---|---|---|---|---|
| | **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 | **7.0** | **(7.0)** | 6.5 | (6.9) |
| Foreign exchange options | **0.3** | **(0.3)** | 0.6 | (0.6) |
| Interest rate swaps and swaptions | **92.0** | **(86.6)** | 30.2 | (28.1) |
| Total return swaps | **-** | **(0.3)** | - | - |
| Interest rate futures | **-** | **-** | 0.1 | - |
| Credit default swaps | **-** | **-** | 0.7 | (2.1) |
| Contracts for differences | **-** | **-** | 1.3 | - |
| | **99.3** | **(94.2)** | 39.4 | (37.7) |
| Derivatives held as cash flow hedges:- | | | | |
| Interest rate swaps | **14.2** | **-** | 2.2 | - |
| Forward foreign exchange contracts | **-** | **(7.0)** | - | - |
| | **14.2** | **(7.0)** | 2.2 | - |
| Derivatives held as fair value hedges:- | | | | |
| Interest rate swaps | **-** | **(57.7)** | 4.7 | (47.8) |
| **Amount included in other assets / (other liabilities)** | **113.5** | **(158.9)** | 46.3 | (85.5) |

### e) Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2008 or at 31st December 2007.

## 30. DERIVATIVE AND FOREIGN EXCHANGE INSTRUMENTS (continued)

### f) Hedge effectiveness

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

| | **2008 US$ millions** | 2007 US$ millions |
|---|---|---|
| Net losses on derivative hedging instruments | **(19.6)** | (13.1) |
| Net gains on hedged items attributable to the hedged risk | **19.6** | 13.1 |

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 2008 or 31st December 2007.

The periods over which the Group was hedging its exposure to the variability in future cash flows for forecasted transactions were as follows:-

| | **At 31.12.08 US$ millions** | At 31.12.07 US$ millions |
|---|---|---|
| Year 1 | **75.0** | 350.0 |
| Years 2 & 3 | **200.0** | 75.0 |
| Years 4 & 5 | **100.0** | - |

## 31. CREDIT-RELATED FINANCIAL INSTRUMENTS

Credit-related financial instruments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The 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.

| | **31.12.08** | | 31.12.07 | |
|---|---|---|---|---|
| | **Notional principal amount US$ millions** | **Risk-weighted exposure US$ millions** | Notional principal amount US$ millions | Risk-weighted exposure US$ millions |
| Direct credit substitutes | **334.6** | **283.6** | 2,269.2 | 595.2 |
| Transaction-related contingent items | **1,147.2** | **440.0** | 1,505.1 | 700.0 |
| Short-term self-liquidating trade-related contingent items | **546.4** | **89.9** | 588.9 | 99.7 |
| Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities | **1,609.3** | **782.8** | 2,898.7 | 1,180.5 |
| | **3,637.5** | **1,596.3** | 7,261.9 | 2,575.4 |

Commitments may be drawdown on demand.

## 31. CREDIT-RELATED FINANCIAL INSTRUMENTS (continued)

Credit-related financial instruments are reported gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2008 the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related financial instruments amounting to US$433.8 million (2007: US$2,041.3 million).
Direct credit substitutes at 31st December 2007 included a US$2.0 billion credit facility for which the Group was acting on behalf of a syndicate of banks. The facility matured during March 2008.

## 32. 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.

## 33. CAPITAL ADEQUACY

The CBB's Basel 2 guidelines became effective on 1st January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 2 capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

## 33. CAPITAL ADEQUACY (continued)

The risk asset ratio calculated in accordance with the CBB's Basel 2 guidelines (2007: the Basel 1 guidelines of the Basel Committee on Banking Supervision) was as follows:-

| | | 31.12.08 US$ millions Basel 2 | 31.12.07 US$ millions Basel 1 |
|---|---|---|---|
| **Regulatory capital base** | | | |
| Tier 1 capital: | | | |
| Total equity | | **1,925.5** | 2,215.3 |
| Adjustment to exclude net fair value losses | | **59.9** | 166.3 |
| Tier 1 capital | | **1,985.4** | 2,381.6 |
| Tier 2 capital: | | | |
| Subordinated term financing | | **550.0** | 550.0 |
| Non-specific provisions subject to 1.25% risk weighted exposure limitation | | **198.7** | 65.0 |
| Unrealised gains on fair value of equity investments | | **13.8** | - |
| Tier 2 capital | | **762.5** | 615.0 |
| **Total regulatory capital base** | *(a)* | **2,747.9** | 2,996.6 |

**Risk-weighted exposure**

| | Notional principal amount US$ millions | Basel 2 Risk-weighted exposure US$ millions | Notional principal amount US$ millions | Basel 1 Risk-weighted exposure US$ millions |
|---|---|---|---|---|
| *Credit risk* | | | | |
| Balance sheet items: | | | | |
| Cash and other liquid assets | **303.0** | **50.5** | 532.7 | 127.6 |
| Due from brokers | - | - | 243.3 | - |
| Placements | **4,037.4** | **798.7** | 5,629.1 | 1,006.4 |
| Due from shareholders | **4,832.0** | - | - | - |
| Investment securities | **2,220.5** | **1,167.1** | 8,070.7 | 7,215.7 |
| Loans and advances | **12,972.1** | **10,637.7** | 12,601.8 | 11,384.8 |
| Other assets | **461.4** | **343.2** | 1,533.8 | 993.9 |
| | | **12,997.2** | | 20,728.4 |
| Off-balance sheet items: | | | | |
| Credit-related contingent items and forward placements | **3,642.1** | **1,597.3** | 7,261.9 | 2,575.4 |
| Foreign exchange-related items | **4,339.3** | **27.4** | 5,303.4 | 17.6 |
| Derivative-related items | **5,371.5** | **3.1** | 8,625.4 | 10.8 |
| Repo counterparty risk | | **79.7** | | n/a |
| | | **1,707.5** | | 2,603.8 |
| **Credit risk-weighted exposure** | | **14,704.7** | | 23,332.2 |
| *Market risk* | | | | |
| General market risk | | **314.7** | | 416.4 |
| Specific market risk | | **266.9** | | 1,193.2 |
| **Market risk-weighted exposure** | | **581.6** | | 1,609.6 |
| *Operational risk* | | | | |
| **Operational risk-weighted exposure** | | **607.9** | | n/a |
| **Total risk-weighted exposure** | *(b)* | **15,894.2** | | 24,941.8 |
| **Risk asset ratio** [ (a)/(b) x 100 ] | | **17.3%** | | 12.0% |

## 33. CAPITAL ADEQUACY (continued)

For regulatory Basel 2 purposes, the Group has initially adopted the standardised approach for credit risk. In time and subject to approval by the CBB, the Group plans to adopt the foundation internal ratings-based (FIRB) approach for credit risk as it is more closely aligned to the Group's internal risk and capital management methodologies. For market risk, the Group uses the internal models approach. GIB has initially adopted the basic indicator approach for determining the capital requirement for operational risk, although is planning to adopt the standardised approach for operational risk subject to approval by the CBB.

In accordance with the capital adequacy guidelines of the 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 equity securities classified as available-for-sale. In accordance with the CBB's guidelines, gains arising on the remeasurement to fair value of equity securities classified as available-for-sale are included in tier 2 capital, although gains are limited to 45 per cent.

The Group calculates the regulatory 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 3.75 (2007: 3.0) by the CBB. The multiplication factor was increased by the CBB during 2008 based on the number of backtesting exceptions recorded in the 2007 financial year. The trading-related exposures that gave rise to the backtesting exceptions in 2007 were liquidated in the three months ended 31st March 2008.

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

The Group calculates the regulatory capital requirement for operational risk by applying an alpha co-efficient of 15 per cent to the average gross income for the preceding three financial years.

## 34. FIDUCIARY ACTIVITIES

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31st December 2008 was US$14,337.3 million (2007: US$24,089.7 million). The decrease in assets held in trust or in a fiduciary capacity was due to both a decline in the market value of the assets and the effect of foreign exchange rate movements.

## 35. 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:-

| | **2008** US$ millions | 2007 US$ millions |
|---|---|---|
| Short term employee benefits | **8.7** | 9.7 |
| Post-employment benefits | **4.4** | 0.7 |
| | **13.1** | 10.4 |

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

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

There were no other related party transactions.

## 36. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, 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 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 carrying amounts, other than term financing as referred to in note 36(c).

### a) Trading and investment securities

The fair values of securities are based on quoted prices or valuation techniques with the exception of investments in unquoted equity investments for which fair values cannot be reliably measured, the fair values of which are based on their carrying amount.

### 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 observable market data, including quoted market prices for debt instruments issued by similarly rated financial institutions and with similar maturities, or estimated on a discounted cash flow basis utilising currently prevailing spreads for borrowings with similar maturities. The fair values of senior term financing and subordinated term financing at 31st December 2008 were US$2,206.7 million and US$491.2 million respectively (2007: US$2,657.8 million and US$550.0 million respectively).

### d) Other on-balance sheet items

The fair values of foreign exchange and derivative financial instruments are based on market prices, discounted cash flow techniques or option pricing models as appropriate. The fair values of all other on-balance sheet financial assets and liabilities 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.

## 36. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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

| | Quoted prices US$ millions | Valuation based on observable market data US$ millions | Other valuation techniques or amortised cost US$ millions | Total US$ millions |
|---|---|---|---|---|
| **At 31st December 2008** | | | | |
| Financial assets: | | | | |
| Trading securities | **207.1** | **-** | **-** | **207.1** |
| Investment securities | **1,966.2** | **49.6** | **204.7** | **2,220.5** |
| Derivative financial instruments | **-** | **113.2** | **0.3** | **113.5** |
| Financial liabilities: | | | | |
| Derivative financial instruments | **-** | **158.6** | **0.3** | **158.9** |
| **At 31st December 2007** | | | | |
| Financial assets: | | | | |
| Trading securities | 1,342.6 | - | - | 1,342.6 |
| Investment securities | 7,338.3 | 454.8 | 277.6 | 8,070.7 |
| Derivative financial instruments | - | 45.7 | 0.6 | 46.3 |
| Financial liabilities: | | | | |
| Securities sold but not yet purchased | 233.2 | - | - | 233.2 |
| Derivative financial instruments | 2.1 | 82.8 | 0.6 | 85.5 |

Quoted prices include prices obtained from lead managers, brokers and dealers. The majority of the Group's financial assets and liabilities that are carried at fair value are valued based on quoted market prices. At 31st December 2008, 85.4 per cent of financial assets carried at fair value were valued based on quoted prices (2007: 91.8 per cent). Financial assets valued based on amortised cost included US$130.8 million of unquoted equity investments (2007: US$107.2 million), for which the carrying value was determined based on cost less provision for impairment.

## 37. EARNINGS PER SHARE

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

| | **2008** | 2007 |
|---|---|---|
| Net loss after tax (US$ millions) | **(396.2)** | (757.3) |
| Weighted average number of shares in issue (millions) | **2,500** | 1,385 |
| Basic earnings per share | **(US$0.16)** | (US$0.55) |

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

The reclassification of securities from held-for-trading to available-for-sale, referred to in note 9, did not have any impact on the basic earnings per share.

## 38. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

| | Country of incorporation | Ownership interest 31.12.08 | 31.12.07 |
|---|---|---|---|
| Gulf International Bank (UK) Limited | United Kingdom | **100%** | 100% |
| GIB Financial Services L.L.C. | Kingdom of Saudi Arabia | **100%** | - |
| GIBINVEST E.C. | Kingdom of Bahrain | **100%** | 100% |

## 39. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

| | At 31.12.08 US$ millions | At 31.12.07 US$ millions |
|---|---|---|
| **Assets** | | |
| Cash and other liquid assets | **222.3** | 314.0 |
| Due from brokers | **10.5** | 628.2 |
| Placements with banks | **5,549.4** | 5,512.8 |
| Due from shareholders | **13.2** | - |
| Trading securities | **435.2** | 1,798.7 |
| Investment securities | **7,714.6** | 8,290.9 |
| Loans and advances | **13,090.0** | 10,407.9 |
| Other assets | **375.6** | 529.6 |
| **Total assets** | **27,410.8** | 27,482.1 |
| **Liabilities** | | |
| Deposits from banks | **4,451.8** | 5,885.1 |
| Deposits from customers | **13,681.8** | 13,050.7 |
| Securities sold under agreements to repurchase | **3,352.3** | 2,466.5 |
| Securities sold but not yet purchased | **7.3** | 554.9 |
| Other liabilities | **889.9** | 598.5 |
| Senior term financing | **2,585.0** | 2,303.5 |
| Subordinated term financing | **550.0** | 539.4 |
| **Total liabilities** | **25,518.1** | 25,398.6 |
| **Total equity** | **1,892.7** | 2,083.5 |
| **Total liabilities & equity** | **27,410.8** | 27,482.1 |

## 40. PARENT COMPANY

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

### a) Condensed balance sheet

| | At 31.12.08 US$ millions | At 31.12.07 US$ millions |
|---|---|---|
| **Assets** | | |
| Cash and other liquid assets | **154.3** | 505.5 |
| Placements with banks | **943.4** | 2,191.2 |
| Due from shareholders | **4,832.0** | - |
| Trading securities | **174.6** | 398.4 |
| Investment securities | **2,219.8** | 8,058.1 |
| Investments in subsidiaries | **228.6** | 250.6 |
| Loans and advances | **13,009.5** | 12,533.3 |
| Other assets | **407.7** | 1,452.9 |
| **Total assets** | **21,969.9** | 25,390.0 |
| **Liabilities** | | |
| Deposits from banks | **3,262.8** | 5,924.2 |
| Deposits from customers | **11,876.8** | 9,473.5 |
| Securities sold under agreements to repurchase | **1,464.8** | 4,112.8 |
| Other liabilities | **458.5** | 456.4 |
| Senior term financing | **2,431.5** | 2,657.8 |
| Subordinated term financing | **550.0** | 550.0 |
| **Total liabilities** | **20,044.4** | 23,174.7 |
| **Total equity** | **1,925.5** | 2,215.3 |
| **Total liabilities & equity** | **21,969.9** | 25,390.0 |

The investments in subsidiaries are accounted for at fair value. Gains and losses arising from changes in the fair values of the investments are accounted for in equity.

### b) Condensed income statement

| | Year ended 31.12.08 US$ millions | Year ended 31.12.07 US$ millions |
|---|---|---|
| Net interest income | **269.3** | 278.4 |
| Fee and commission income | **39.9** | 52.9 |
| Trading (loss) / income | **(59.9)** | 1.8 |
| Profits on invesment securities | **37.0** | 29.6 |
| Dividend received from GIBUK | **-** | 14.1 |
| Other income | **7.7** | 5.5 |
| **Total income** | **294.0** | 382.3 |
| Operating expenses | **98.6** | 86.7 |
| **Net income before provisions and tax** | **195.4** | 295.6 |
| Provisions for securities | **(353.5)** | (962.3) |
| Provisions for loans and advances | **(201.7)** | 6.9 |
| **Net loss before tax** | **(359.8)** | (659.8) |
| Taxation charge on overseas activities | **(3.2)** | (5.7) |
| **Net loss** | **(363.0)** | (665.5) |

# Basel 2 Pillar 3 Report

## EXECUTIVE SUMMARY

The Central Bank of Bahrain (CBB) Basel 2 guidelines became effective on 1st January 2008 as the common framework for the implementation of the Basel Committee on Banking Supervision's (Basel Committee) Basel 2 capital adequacy framework for banks incorporated in the Kingdom of Bahrain.

Since 2006, GIB (the Group) has routinely been monitoring capital adequacy for internal capital management purposes based on both the Basel 2 standardised and the foundation internal ratings based (FIRB) approaches for credit risk, and the basic indicator and standardised approaches for operational risk, in addition to the internal models approach for market risk.

For regulatory purposes, GIB has initially adopted the standardised approach for credit risk. In time and subject to approval by the CBB, GIB plans to adopt the FIRB approach for credit risk, as it is more closely aligned to the Group's internal capital management methodologies. For market risk, GIB uses the internal model approach. GIB has initially adopted the basic indicator approach for determining the capital requirement for operational risk although is planning to adopt the standardised approach for operational risk when approved by the CBB.

This Risk Management and Capital Adequacy report encompasses the Basel 2 Pillar 3 disclosure requirements prescribed by the CBB based on the Basel Committee's Pillar 3 guidelines. The report contains a description of GIB's risk management and capital adequacy policies and practices, including detailed information on the capital adequacy process.

The disclosed tier 1 and total capital adequacy ratios comply with the minimum capital requirements under the CBB's Basel 2 framework.

GIB's total risk-weighted assets at 31st December 2008 amounted to US$15,894.2 million. Credit risk accounted for 92.5 per cent, market risk 3.7 per cent and operational risk 3.8 per cent of the total risk-weighted assets. Tier 1 and total regulatory capital were US$1,985.4 million and US$2,747.9 million respectively.

At 31st December 2008, GIB's tier 1 and total capital adequacy ratios were 12.5 per cent and 17.3 per cent respectively. GIB aims to maintain a tier 1 capital ratio above 8 per cent and a total capital ratio in excess of 12 per cent.

GIB views the Basel 2 Pillar 3 disclosures as an important contribution to increased risk transparency within the banking industry, and particularly important during market conditions characterised by high uncertainty. In this regard, GIB has provided more disclosure in this report than is required in accordance with the CBB's Pillar 3 guidelines in order to provide the level of transparency that is believed to be appropriate and relevant to the Group's various stakeholders and market participants.

All figures presented in this report are as at 31st December 2008 unless otherwise stated.

## 1. INTRODUCTION TO THE BASEL 2 FRAMEWORK

The new capital adequacy module of the Central Bank of Bahrain (CBB) rulebook was introduced with effect from 1st January 2008. The module includes a change of methodology from the previous (Basel 1) non-risk based method of calculating the capital adequacy requirements of banks incorporated in Bahrain. The Basel 2 framework provides a more risk sensitive approach to the assessment of risk and the calculation of regulatory capital, i.e. the minimum capital that a bank is required to maintain. The Basel 2 framework is intended to strengthen risk management practices and processes within financial institutions.

The CBB's Basel 2 framework is based on three pillars, consistent with the Basel 2 framework developed by the Basel Committee, as follows:-

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

### 1.1 Pillar 1

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

## 1. INTRODUCTION TO THE BASEL 2 FRAMEWORK (continued)

### 1.1 Pillar 1 (continued)

The resultant ratio is to be maintained above a predetermined and communicated level. Under the previously applied Basel 1 Capital Accord, the minimum capital adequacy ratio for banks incorporated in Bahrain was 12 per cent compared to the Basel Committee's minimum ratio of 8 per cent.

With the imminent introduction of Pillar 2, the CBB will implement a minimum ratio threshold to be determined for each institution individually, as described in more detail in the Pillar 2 section of this report. As at 31st December 2008, and pending the finalisation of the CBB's Pillar 2 guidelines, all banks incorporated in Bahrain were required to maintain a minimum capital adequacy ratio of 12 per cent.

The CBB also requires banks incorporated in Bahrain to maintain a buffer of 0.5 per cent above the minimum capital adequacy ratio. In the event that the capital adequacy ratio falls below 12.5 per cent additional prudential reporting requirements apply, and a formal action plan setting out the measures to be taken to restore the ratio above the target level is to be formulated and submitted to the CBB. Consequently, the CBB requires GIB to maintain an effective minimum capital adequacy ratio of 12.5 per cent. No separate minimum tier 1 ratio is required to be maintained under the CBB's Basel 2 capital adequacy framework. However, the maintenance of a strong tier 1 ratio is nevertheless a focus of GIB's internal capital adequacy assessment process, as it represents the core capital of the bank.

Under the CBB's Basel 2 capital adequacy framework, the RWAs are calculated using more sophisticated and risk sensitive methods than under the previous Basel 1 regulations. Credit risk and market risk are two essential risk types that were included under Basel I, while operational risk has been introduced as a new risk type in the CBB's Basel 2 capital adequacy framework. The table below summarises the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel 2 capital adequacy framework:-

| Approaches for determining regulatory capital requirements | | |
|---|---|---|
| **Credit Risk** | **Market Risk** | **Operational Risk** |
| Standardised Approach | Standardised Approach | Basic Indicator Approach |
| Foundation Internal Ratings Based Approach (FIRB) | Internal Models Approach | Standardised Approach |

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

#### i) Credit risk

For regulatory reporting purposes, GIB is using the standardised approach for credit risk. The standardised approach is similar to the basis under the previous Basel 1 capital adequacy regulations, except for the use of external ratings to derive RWAs and the ability to use a wider range of financial collateral.

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

Internally, GIB also calculates the capital requirement under the more risk-sensitive and complex FIRB approach, although the resultant ratio is not being used for regulatory compliance purposes at present.

#### ii) Market risk

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

#### iii) Operational risk

Under the CBB's Basel 2 capital adequacy framework, all banks incorporated in Bahrain are required to apply the basic indicator approach for operational risk unless approval is granted by the CBB to use the standardised approach. The CBB's Basel 2 guidelines do not currently permit the use of the advanced measurement approach (AMA) for operational risk. For regulatory reporting purposes, GIB is currently using the basic indicator approach, although internally the Group also calculates the capital requirement based on the more advanced standardised approach.

## 1. INTRODUCTION TO THE BASEL 2 FRAMEWORK (continued)

### 1.1 Pillar 1 (continued)

### iii) Operational risk (continued)

Under the basic indicator approach, the regulatory capital requirement is calculated by applying an alpha co-efficient of 15 per cent to the average gross income for the preceding three financial years. Under the standardised approach, the regulatory capital requirement is calculated based on a range of beta coefficients, ranging between 12 and 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines.

### 1.2 Pillar 2

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

The new CBB capital adequacy framework no longer applies a flat minimum capital adequacy ratio requirement of 12 per cent as required under the previous Basel 1 framework.

Under the CBB's Pillar 2 guidelines, each bank is to be individually assessed by the CBB and an individual minimum capital adequacy ratio is to be determined for each bank. The CBB is currently undertaking the assessment exercises, which will allow their setting of minimum capital ratios in excess of 8 per cent, based on the CBB's assessment of the financial strength and risk management practices of the institution. Currently, pending finalisation of the assessment process all banks incorporated in Bahrain are required to continue to maintain a 12 per cent minimum capital adequacy ratio as under the previous Basel 1 framework.

Pillar 2 comprises two processes:

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

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

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

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

### 1.3 Pillar 3

In the CBB's Basel 2 framework, the third pillar prescribes how, when, and at what level information should be disclosed about an institution's risk management and capital adequacy practices.

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

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

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

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT

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

### 2.1 Group structure

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

Under the CBB capital adequacy framework, subsidiaries reporting under a Basel 2 framework in other regulatory jurisdictions may, at the bank's discretion, be consolidated based on that jurisdiction's Basel 2 framework, rather than based on the CBB's guidelines. Under this aggregation consolidation methodology, the risk weighted assets of subsidiaries are consolidated with those of the rest of the Group based on the guidelines of their respective regulator to determine the Group's total risk weighted assets.

GIB's principal subsidiary, GIBUK, is regulated by the Financial Services Authority (FSA) of the United Kingdom, and has calculated its risk weighted assets in accordance with the FSA's guidelines.

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

| Subsidiary | Domicile | Ownership | Consolidation basis |
|---|---|---|---|
| Gulf International Bank (UK) Limited | United Kingdom | 100% | Aggregation |
| GIB Financial Services LLC | Saudi Arabia | 100% | Full Consolidation |
| GIBINVEST E.C. | Bahrain | 100% | Full Consolidation |

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

### 2.2 Risk and capital management

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

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

The Management Committee, chaired by the Chief Executive Officer (CEO), has the primary responsibility for sanctioning risk taking policies and activities within the tolerances defined by the Board. The Group Risk Committee assists the Management Committee in performing its risk related functions.

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

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT (continued)

### 2.2 Risk and capital management (continued)

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

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

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 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 Chief Financial Officer (CFO) is responsible for the strategic planning process incorporating capital planning. Capital planning includes capital adequacy reporting, economic capital and parameter estimation, i.e. probability of default (PD) and loss given default (LGD) estimates, used for the calculation of economic capital. The CFO is also responsible for the balance sheet management framework.

The governance structure for risk and capital management is illustrated in the table below:-

| | | |
|---|---|---|
| | **Board of Directors** | |
| **Audit Committee** | | **Board Risk Policy Committee** |
| | **Chief Executive Officer** | |
| **Management Committee**<br>**(Chairman: CEO)** | **Group Risk Committee**<br>**(Chairman: MD RM)** | **Assets and Liabilities Committee**<br>**(Chairman: CI & TO)** |

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

| | |
|---|---|
| **Chief Executive Officer** | |
| **Chief Financial Officer**<br>**(CFO)** | **Managing Director – Risk Management**<br>**(MD RM)** |
| Balance sheet management framework<br>Capital management framework<br>Market and operational risk monitoring and reporting<br>Liquidity monitoring and reporting | Risk management framework and policies<br>Group credit control<br>Credit risk monitoring and reporting |

### 2.3 Risk types

The major risks associated with the Group's business activities are credit, market, operational and liquidity risk. These risks together with a commentary on the way in which the risks are managed and controlled are set out below, based on the Basel 2 pillar in which the risks are addressed.

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT (continued)

### 2.4 Risk in Pillar 1

Pillar 1, which forms the basis for the calculation of the regulatory capital requirement, addresses three specific risk types: credit, market and operational risk.

### i) Credit risk

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

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

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is undertaken which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each counterparty, which affects the credit approval decision and the terms and conditions of the transaction. For cross-border transactions, an analysis of country risk is also conducted. The credit decision for an individual counterparty is based on the aggregate Group exposure to that counterparty and all its related entities. Groupwide credit limit setting and approval authorisation requirements are conducted within Board approved guidelines, and the measurement, monitoring and control of credit exposures are done on a Groupwide basis in a consistent manner. Overall exposures are evaluated to ensure broad diversification of credit risk. Potential concentration risks by product, industry, single obligor, credit risk rating and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by the MD RM, Chief Credit Officer and other members of senior management. All credit exposures are reviewed at least once a year. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review. The credit risk associated with foreign exchange and derivative instruments is assessed in a manner similar to that associated with on-balance sheet activities. The Group utilises derivative transactions for proprietary trading, to facilitate customer transactions and for the management of interest and foreign exchange risks associated with the Group's longer-term lending, borrowing and investment activities. Unlike on-balance sheet products, where the principal amount and interest generally represent the maximum credit exposure, the notional amount relating to a foreign exchange or derivative transaction typically exceeds the credit exposure by a substantial margin. The measure of credit exposure for foreign exchange and derivative instruments is therefore more appropriately considered to be the replacement cost at current market rates plus an add-on amount commensurate with the position's size, volatility and remaining life. Derivative contracts may also carry legal risk; the Group seeks to minimise these risks by the use of standard contract agreements.

### ii) Market risk

Market risk is the risk of loss of value of a financial instrument or a portfolio of financial instruments as a result of adverse changes in market prices and rates, and market conditions such as liquidity. Market risk arises from the Group's trading, asset and liability management and investment activities.

The categories of market risk to which the Group is exposed are as follows:-

**Interest rate risk** results from exposure to changes in the level, slope, curvature and volatility of interest rates and credit spreads. The credit spread risk is the risk that the interest yield for a security will increase, with a reduction in the security price, relative to benchmark yields as a result of the general market movements for that rating and class of security. Interest rate risk is the principal market risk faced by the Group and arises from the Group's investment activities in debt securities, asset and liability management, and the trading of debt and off-balance sheet derivative instruments.

**Foreign exchange risk** results from exposure to changes in the price and volatility of currency spot and forward rates. The principal foreign exchange risk arises from the Group's foreign exchange forward and derivative trading activities.

**Equity risk** arises from exposures to changes in the price and volatility of individual equities or equity indices.

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT (continued)

### 2.4 Risk in Pillar 1 (continued)

#### ii) Market risk (continued)

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

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (i.e. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are 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, the events of 9/11 and the 2007 US subprime crisis. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

#### iii) 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 the risk 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 control processes, as applicable.

### 2.5 Risk in Pillar 2

Other risk types are measured and assessed in Pillar 2. GIB measures and manages these risk types although they are not included in the calculation of the regulatory capital adequacy ratio. Most of the Pillar 2 risks are included in GIB's calculation of internal economic capital. Pillar 2 risk types include liquidity risk, interest rate risk in the banking book, business risk and concentration risk.

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT (continued)

### 2.5 Risk in Pillar 2 (continued)

#### i) Liquidity risk

Liquidity risk is the risk that sufficient funds are not available to meet the Group's financial obligations on a punctual basis as they fall due. The risk arises from the timing differences between the maturity profiles of the Group's assets and liabilities. It includes the risk of losses arising from the following:-

- Forced sale of assets at below normal market prices
- Raising of deposits or borrowing funds at excessive rates
- The investment of surplus funds at below market rates

Liquidity management policies are designed to ensure that funds are available at all times to meet the funding requirements of the Group, even in adverse conditions. In normal conditions, the objective is to ensure that there are sufficient funds available not only to meet current financial commitments but also to facilitate business expansion. These objectives are met through the application of prudent liquidity controls. These controls provide access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits.

The Group's liquidity controls ensure that, over the short term, the future profile of cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity controls also provide for the maintenance of a stock of liquid and readily realisable assets and a diversified deposit base in terms of both maturities and range of depositors.

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within approved limits. The limits take account of the depth and liquidity of the market in which the entity operates.

It is the Group's general policy that each geographic entity should be self-sufficient in relation to funding its own operations.

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

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

#### ii) Concentration risk

Concentration risk is the risk related to the degree of diversification in the credit portfolio, i.e. the risk inherent in doing business with large customers or not being equally exposed across industries and regions.

Concentration risk is captured in GIB's economic capital framework through the use of a credit risk portfolio model which considers single-name concentrations in the credit portfolio. Economic capital add-ons are applied where counterparty exposures exceed specified thresholds.

Potential concentration risks by product, industry, single obligor, and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by senior management and the Board of Directors.

#### iii) Interest rate risk in the banking book

Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates.

## 2. GROUP STRUCTURE AND OVERALL RISK AND CAPITAL MANAGEMENT (continued)

### 2.5 Risk in Pillar 2 (continued)

#### iv) Business risk

Business risk represents the earnings volatility inherent in all businesses due to the uncertainty of revenues and costs associated with changes in the economic and competitive environment. Business risk is evaluated based on the observed volatility in historical profits and losses.

### 2.6 Monitoring and reporting

The monitoring and reporting of risk is conducted on a daily basis for market and liquidity risk, on a monthly or quarterly basis for credit risk, and on a quarterly basis for operational risk.

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

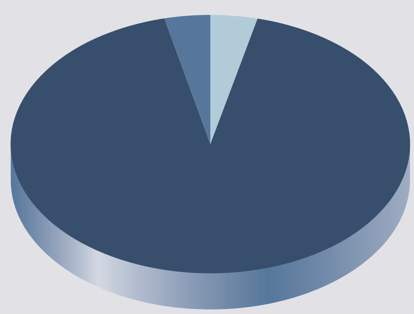
Capital management, including regulatory and internal economic capital ratios, is reported to senior management and the Board of Directors on a monthly basis.

## 3. REGULATORY CAPITAL REQUIREMENTS AND THE CAPITAL BASE

This section describes the Group's regulatory capital requirements and capital base.

The composition of the total regulatory capital requirement was as follows:-

**Regulatory capital requirements**



| | % |
|---|---|
| Credit risk capital | 92.5 |
| Market risk capital | 3.7 |
| Operational risk capital | 3.8 |
| **Total** | **100.0** |

### 3.1 Capital requirements for credit risk

For regulatory reporting purposes, GIB calculates the capital requirements for credit risk based on the standardised approach. Under the standardised approach on- and off-balance sheet credit exposures are assigned to exposure categories based on the type of counterparty or underlying exposure. The exposure categories are referred to in the CBB's Basel 2 capital adequacy framework as standard portfolios. The primary standard portfolios are claims on sovereigns, claims on banks and claims on corporates. Following the assignment of exposures to the relevant standard portfolios, the RWAs are derived based on prescribed risk weightings. Under the standardised approach, the risk weightings are provided by the CBB and are determined based on the counterparty's external credit rating. The external credit ratings are derived from eligible external rating agencies approved by the CBB. GIB uses ratings assigned by Standard & Poor's, Moody's and Fitch.

## 3. REGULATORY CAPITAL REQUIREMENTS AND THE CAPITAL BASE (continued)

### 3.1 Capital requirements for credit risk (continued)

An overview of the exposures, RWAs and capital requirements for credit risk analysed by standard portfolio is presented in the table below:-

| | Rated exposure US$ millions | Unrated exposure US$ millions | Total exposure US$ millions | Average risk weight per cent | RWA US$ millions | Capital requirement US$ millions |
|---|---|---|---|---|---|---|
| Sovereigns | 5,809.7 | 0.2 | 5,809.9 | 2% | 105.9 | 12.7 |
| PSEs | - | 9.7 | 9.7 | 100% | 9.7 | 1.2 |
| Banks | 7,624.1 | 315.1 | 7,939.2 | 30% | 2,400.8 | 288.1 |
| Corporates | 1,468.9 | 11,056.2 | 12,525.1 | 93% | 11,648.8 | 1,397.9 |
| Equities | - | 209.3 | 209.3 | 150% | 314.0 | 37.7 |
| Past due loans | - | 1.0 | 1.0 | 100% | 1.0 | 0.1 |
| Other assets | 63.2 | 176.7 | 239.9 | 94% | 224.5 | 26.9 |
| **Total** | **14,965.9** | **11,768.2** | **26,734.1** | **55%** | **14,704.7** | **1,764.6** |

Exposures are stated after taking account of credit risk mitigants where applicable. The treatment of credit risk mitigation is explained in more detail in section 4.4(vii) of this report.

The unrated exposure to banks principally represented unrated subordinated loans to rated banks.

The definitions of each standard portfolio and the related RWA requirements are set out in section 4 of this report.

### 3.2 Capital requirements for market risk

GIB uses a Value-at-Risk (VaR) model to calculate the regulatory capital requirements relating to general market risk.

The VaR calculated by the internal model is subject to a multiplication factor determined by the CBB. GIB's multiplication factor has been set at 3.75 by the CBB. The multiplication factor was increased by the CBB from the regulatory minimum of 3.0 during 2008, based on the number of back testing exceptions recorded in the financial year ended 31st December 2007. The trading-related exposures that gave rise to the back testing exceptions in 2007 were liquidated in the three months ended 31st March 2008.

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 theoretical 8 per cent minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

The RWAs and capital requirements for market risk are presented in the table below:-

| | RWA US$ millions | Capital requirement US$ millions |
|---|---|---|
| Equity risk | 227.3 | 27.3 |
| Interest rate risk | 77.2 | 9.3 |
| Foreign exchange risk | 10.2 | 1.2 |
| Total general market risk | 314.7 | 37.8 |
| Total specific market risk | 266.9 | 32.0 |
| **Total** | **581.6** | **69.8** |

The equity general market risk principally related to alternative investment funds managed by external managers.

### 3.3 Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated according to the basic indicator approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a fixed alpha coefficient. The alpha coefficient has been set at 15 per cent in the CBB's Basel 2 capital adequacy framework.

The capital requirement for operational risk at 31st December 2008 amounted to US$72.9 million.

## 3. REGULATORY CAPITAL REQUIREMENTS AND THE CAPITAL BASE (continued)

### 3.4 Capital base

The regulatory capital base is set out in the table below:-

| | Tier 1 US$ millions | Tier 2 US$ millions | Total US$ millions |
|---|---|---|---|
| Share capital | 2,500.0 | - | 2,500.0 |
| Share premium | 7.6 | - | 7.6 |
| Compulsory reserve | 169.2 | - | 169.2 |
| Voluntary reserve | 106.7 | - | 106.7 |
| Retained earnings | (798.1) | - | (798.1) |
| Unrealised gains on fair valuing AFS equity investments | - | 13.8 | 13.8 |
| Collective impairment provisions (subject to 1.25% RWA limitation) | - | 198.7 | 198.7 |
| Subordinated term debt | - | 550.0 | 550.0 |
| **Tier 1 and tier 2 capital base** | **1,985.4** | **762.5** | **2,747.9** |

Tier 1 capital is defined as capital of the same or close to the character of paid up capital and comprises share capital, share premium, retained earnings and eligible reserves. Retained losses, including the losses for the current year, are included in tier 1 following the external audit. Eligible reserves excludes 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 gains and losses arising on the remeasurement to fair value of equity securities classified as available-for-sale. Unrealised gains on equity securities classified as available-for-sale are included in tier 2 capital.

Tier 2 capital comprises qualifying subordinated term finance, collective impairment provisions and 45 per cent of unrealised gains arising on the remeasurement to fair value of equity securities classified as available-for-sale.

The subordinated term financing facilities, amounting to US$550.0 million, 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 regulatory capital adequacy purposes by the CBB.

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

In accordance with the CBB's Basel 2 capital adequacy framework, securitisation exposures that are rated below BB- or that are unrated are to be deducted from regulatory capital rather than included in RWAs. At 31st December 2008, the Group had no exposure, net of specific provisions, to securitisations.

There are no impediments on the transfer of funds or regulatory capital within the Group other than restrictions over transfers to ensure minimum regulatory capital requirements are met for subsidiary companies.

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES

This section describes the Group's exposure to credit risk and provides detailed disclosures on credit risk in accordance with the CBB's Basel 2 framework in relation to Pillar 3 disclosure requirements.

### 4.1 Definition of exposure classes

GIB has a diversified on- and off-balance sheet credit portfolio, the exposures of which are divided into the counterparty exposure classes defined by the CBB's Basel 2 capital adequacy framework for the standardised approach for credit risk. A high-level description of the counterparty exposure classes, referred to as standard portfolios in the CBB's Basel 2 capital adequacy framework, and the generic treatments, i.e. the risk weights to be used to derive the RWAs, are as follows:-

**Sovereigns Portfolio**
The sovereigns portfolio comprises exposures to governments and their respective central banks. The risk weights are 0 per cent for exposures in the relevant domestic currency, or in any currency for exposures to GCC governments. Foreign currency claims on other sovereigns are risk weighted based on their external credit ratings.

Certain multilateral development banks as determined by the CBB may be included in the sovereigns portfolio and treated as exposures with a 0 per cent risk weighting.

**PSE Portfolio**
Public sector entities (PSEs) are risk weighted according to their external ratings with the exception of Bahrain PSEs, and domestic currency claims on other PSEs which are assigned a 0 per cent risk weight by their respective country regulator, which are assigned a 0 per cent risk weight.

**Banks Portfolio**
Claims on banks are risk weighted based on their external credit ratings. A preferential risk weight treatment is available for qualifying short term exposures. Short term exposures are defined as exposures with an original tenor of three months or less.

The Banks portfolio also includes claims on investment firms, which are risk weighted based on their external credit ratings although without any option for preferential treatment for short term exposures.

**Corporates Portfolio**
Claims on corporates are risk weighted based on their external credit ratings. A 100 per cent risk weight is assigned to exposures to unrated corporates. A preferential risk weight treatment is available for certain corporates owned by the Government of Bahrain, as determined by the CBB, which are assigned a 0 per cent risk weight.

**Equities Portfolio**
The equities portfolio comprises equity investments in the banking book, i.e. the investment securities portfolio. The credit (specific) risk for equities in the trading book is included in market risk RWAs for regulatory capital adequacy calculation purposes.

A 100 per cent risk weight is assigned to listed equities and funds. Unlisted equities and funds are risk weighted at 150 per cent. Investments in rated funds are risk weighted according to the external credit rating. Equity investments in securitisations are deducted from the regulatory capital base.

In addition to the standard portfolios, other exposures are assigned to the following exposure classes:-

**Past due exposures**
All past due loan exposures, irrespective of the categorisation of the exposure if it were performing, are classified separately under the past due exposures asset class. A risk weighting of either 100 per cent or 150 per cent is applied depending on the level of provision maintained against the loan.

**Other assets and holdings of securitisation tranches**
Other assets are risk weighted at 100 per cent.

Securitisation tranches are risk weighted based on their external credit ratings. Risk weightings range from 20 per cent to 350 per cent. Exposures to securitisation tranches that are rated below BB- or are unrated are deducted from regulatory capital rather than subject to a risk weight.

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### 4.2 External rating agencies

GIB uses ratings issued by Standard & Poor's, Moody's and Fitch to derive the risk weightings under the CBB's Basel 2 capital adequacy framework. Where ratings vary between rating agencies, the highest rating from the lowest two ratings is used to represent the rating for regulatory capital adequacy purposes.

### 4.3 Credit risk presentation under Basel 2

The credit risk exposures presented in much of this report differ from the credit risk exposures reported in the consolidated financial statements. Differences arise due to the application of different methodologies, as illustrated below:-

- Under the CBB's Basel 2 framework, off-balance sheet exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off-balance sheet exposure is multiplied by the relevant CCF applicable to the off-balance sheet exposure category. Subsequently, the exposure is treated in accordance with the standard portfolios referred to in section 4.1 of this report in the same manner as on-balance sheet exposures.
- Credit risk exposure reporting under Pillar 3 is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Banks standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.
- Certain eligible collateral is applied to reduce exposure under the Basel 2 capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.
- Based on the CBB's Basel 2 guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements, e.g. unrated securitisation tranches.
- Under the CBB's Basel 2 capital adequacy framework, external rating agency ratings are based on the highest rating from the lowest two ratings while for internal credit risk management purposes the Group uses the lowest rating.

### 4.4 Credit exposure

#### i) Gross credit exposure

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

| | Gross credit exposure US$ millions | Average gross credit exposure US$ millions |
|---|---|---|
| **Balance sheet items:** | | |
| Cash and other liquid assets | 303.0 | 222.3 |
| Due from brokers | - | 10.5 |
| Placements with banks | 4,037.4 | 5,549.4 |
| Due from shareholders | 4,832.0 | 13.2 |
| Trading securities | 207.1 | 435.2 |
| Investment securities | 2,220.5 | 7,714.6 |
| Loans and advances | 12,972.1 | 13,090.0 |
| Other assets, excluding derivative-related items | 235.4 | 265.6 |
| **Total on-balance sheet credit exposure** | **24,807.5** | **27,300.8** |
| **Off-balance sheet items:** | | |
| Credit-related contingent items | 3,637.5 | 5,056.5 |
| Derivative and foreign exchange instruments | 199.3 | 182.3 |
| **Total off-balance sheet credit exposure** | **3,836.8** | **5,238.8** |
| **Total credit exposure** | **28,644.3** | **32,539.6** |

The average gross credit exposure is based on daily averages during the year ended 31st December 2008.

Other assets principally comprised accrued interest, fees and commissions.

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### 4.4 Credit exposure (continued)

The gross credit exposure for derivative and foreign exchange instruments is the replacement cost (current exposure) representing the cost of replacing the contracts at current market rates should the counterparty default prior to the settlement date. The gross credit exposure reported in the table above does not include potential future exposure. Further details on the counterparty credit risk relating to off-balance sheet exposures are set out in section 7.3(i) of this report.

### ii) Credit exposure by geography

The classification of credit exposures by geography, based on the location of the counterparty, was as follows:-

| | Placements, due from shareholders and other liquid assets US$ millions | Securities US$ millions | Loans and advances US$ millions | Other assets US$ millions | Off balance sheet items US$ millions | Total US$ millions |
|---|---|---|---|---|---|---|
| GCC | 5,662.0 | 1,412.3 | 12,215.3 | 132.6 | 3,059.1 | 22,481.3 |
| Other MENA region | - | 39.4 | 332.1 | 4.8 | 172.7 | 549.0 |
| Europe | 3,006.0 | 363.2 | 383.8 | 61.3 | 356.6 | 4,170.9 |
| North America | 317.6 | 577.6 | 2.2 | 34.3 | 246.6 | 1,178.3 |
| Asia | 186.8 | 35.1 | 38.7 | 2.4 | 1.8 | 264.8 |
| **Total exposure** | **9,172.4** | **2,427.6** | **12,972.1** | **235.4** | **3,836.8** | **28,644.3** |

The MENA region comprises the Middle East and North Africa.

### iii) Credit exposure by industry

The classification of credit exposures by industry was as follows:-

| | Placements, due from shareholders and other liquid assets US$ millions | Securities US$ millions | Loans and advances US$ millions | Other assets US$ millions | Off balance sheet items US$ millions | Total US$ millions |
|---|---|---|---|---|---|---|
| Financial services | 4,251.4 | 1,316.6 | 2,220.2 | 117.3 | 458.0 | 8,363.5 |
| Energy, oil and petrochemical | - | 241.4 | 3,306.7 | 30.8 | 1,145.5 | 4,724.4 |
| Construction | - | - | 1,079.0 | 11.1 | 1,196.4 | 2,286.5 |
| Trading and services | - | - | 2,201.3 | 14.6 | 205.6 | 2,421.5 |
| Manufacturing | - | 15.6 | 1,054.3 | 6.2 | 318.7 | 1,394.8 |
| Government | 4,921.0 | 410.3 | 444.7 | 8.4 | 43.1 | 5,827.5 |
| Transportation | - | 27.3 | 923.3 | 2.0 | 172.9 | 1,125.5 |
| Real estate | - | - | 833.6 | 21.3 | 88.5 | 943.4 |
| Communication | - | - | 608.4 | 4.7 | 27.0 | 640.1 |
| Equity investments | - | 416.4 | - | - | 7.6 | 424.0 |
| Other | - | - | 300.6 | 19.0 | 173.5 | 493.1 |
| **Total exposure** | **9,172.4** | **2,427.6** | **12,972.1** | **235.4** | **3,836.8** | **28,644.3** |

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### 4.4 Credit exposure (continued)

### iv) Credit exposure by internal rating

The credit risk profile based on internal credit ratings was as follows:-

| | Placements, due from shareholders and other liquid assets US$ millions | Securities US$ millions | Loans and advances US$ millions | Other assets US$ millions | Off balance sheet items US$ millions | Total US$ millions |
|---|---|---|---|---|---|---|
| **Neither past due nor impaired** | | | | | | |
| Rating grades 1 to 4- | 9,172.4 | 1,946.8 | 9,378.3 | 189.1 | 2,902.2 | 23,588.8 |
| Rating grades 5+ to 5- | - | 29.5 | 3,124.6 | 39.5 | 731.8 | 3,925.4 |
| Rating grades 6+ to 6- | - | 15.0 | 354.8 | 5.0 | 110.8 | 485.6 |
| Rating grade 7 | - | 19.9 | 6.7 | 1.8 | 0.8 | 29.2 |
| Rating grade 8 | - | - | - | - | 83.6 | 83.6 |
| Equity investments | - | 389.1 | - | - | 7.6 | 396.7 |
| **Carrying amount** | **9,172.4** | **2,400.3** | **12,864.4** | **235.4** | **3,836.8** | **28,509.3** |
| **Past due or individually impaired** | | | | | | |
| Rating grade 8 | - | - | 26.2 | - | - | 26.2 |
| Rating grade 9 | - | - | 81.5 | - | - | 81.5 |
| Equity investments | - | 27.3 | - | - | - | 27.3 |
| **Carrying amount** | **-** | **27.3** | **107.7** | **-** | **-** | **135.0** |
| **Total** | **9,172.4** | **2,427.6** | **12,972.1** | **235.4** | **3,836.8** | **28,644.3** |

The analysis is presented prior to the application of any credit risk mitigation techniques, for example, the off-balance sheet exposures relating to grade 8 counterparties are fully cash collateralised.

The Group's internal rating system is commented on in more detail in section 8.1 of this report.

### v) Credit exposure by maturity

The maturity profile of funded credit exposures based on contractual maturity dates was as follows:-

| | Placements, due from shareholders and other liquid assets US$ millions | Securities US$ millions | Loans and advances US$ millions | Other assets US$ millions | Total US$ millions |
|---|---|---|---|---|---|
| Within 3 months | 9,171.4 | 318.5 | 3,272.4 | 201.0 | 12,963.3 |
| 4 months to 1 year | 1.0 | 223.1 | 2,755.3 | 34.4 | 3,013.8 |
| Years 2 to 5 | - | 1,209.1 | 4,251.6 | - | 5,460.7 |
| Years 6 to 10 | - | 411.5 | 1,924.2 | - | 2,335.7 |
| Years 11 to 20 | - | 106.5 | 738.8 | - | 845.3 |
| Over 20 years and other | - | 158.9 | 29.8 | - | 188.7 |
| **Total exposure** | **9,172.4** | **2,427.6** | **12,972.1** | **235.4** | **24,807.5** |

An analysis of off-balance sheet exposure is set out in section 7 of this report.

### vi) Equities held in the banking book

Equity investments included in investment securities on the consolidated balance sheet are included in the equities standard portfolio in the Pillar 1 credit risk capital adequacy framework. Such equity investments principally represent investments of a private equity nature, comprising both direct investments and investments in funds managed by external specialist managers and international investment banks.

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### 4.4 Credit exposure (continued)

### vi) Equities held in the banking book (continued)

At 31st December 2008, equity investments held in the banking book amounted to US$209.3 million, of which US$99.6 million comprised managed funds. Unlisted equities, which principally represent private equity investments, are stated at cost less provision for impairment. 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.

During the year ended 31st December 2008, the total realised gains on equity investments amounted to US$26.2 million. At 31st December 2008, unrealised gains on equity investments amounted to US$30.6 million. 45 per cent of the unrealised gains, or US$13.8 million, was included in tier 2 capital in accordance with the CBB's Basel 2 capital adequacy framework.

### vii) Credit risk mitigation

The credit exposure information presented in section 4 of this report represents gross exposures prior to the application of any credit risk mitigation techniques. Collateral items and guarantees which can be used for credit risk mitigation under the capital adequacy framework are referred to as eligible collateral. Only certain types of collateral and some issuers of guarantees are eligible for preferential risk weights for regulatory capital adequacy purposes. Furthermore, the collateral management process and the terms in the collateral agreements have to fulfil the CBB's prescribed minimum requirements (such as procedures for the monitoring of market values, insurance and legal certainty) set out in their capital adequacy regulations.

The reduction of the capital requirement attributable to credit risk mitigation is calculated in different ways, depending on the type of credit risk mitigation, as follows:-

- Adjusted exposure amount: GIB uses the comprehensive method for financial collateral such as cash, bonds and stocks. The exposure amount is adjusted with regard to the financial collateral. The size of the adjustment depends on the volatility of the collateral and the exposure. GIB uses volatility adjustments specified by the CBB, known as supervisory haircuts, to reduce the benefit of collateral and to increase the magnitude of the exposure.
- Substitution of counterparty: The substitution method is used for guarantees, whereby the rating of the counterparty is substituted with the rating of the guarantor. This means that the credit risk in respect of the customer is substituted by the credit risk of the guarantor and the capital requirement is thereby reduced. Hence, a fully guaranteed exposure will be assigned the same capital treatment as if the loan was initially granted to the guarantor rather than to the customer.

**Description of the main types of risk mitigation**

GIB uses a variety of risk mitigation techniques in several different markets which contribute to risk diversification and credit protection. The different credit risk mitigation techniques such as collateral, guarantees, credit derivatives, netting agreements and covenants are used to reduce credit risk. All credit mitigation activities are not necessarily recognised for capital adequacy purposes since they are not defined as eligible under the CBB's Basel 2 capital adequacy framework, e.g. covenants and non-eligible tangible collateral such as unquoted equities.

Exposures secured by eligible financial collateral, guarantees and credit derivatives, presented by standard portfolio were as follows:-

| | Exposure before credit risk mitigation US$ millions | Of which secured by: Eligible collateral US$ millions | Eligible guarantees or credit derivatives US$ millions |
|---|---|---|---|
| Sovereigns | 5,809.9 | - | 483.3 |
| Banks | 8,958.4 | 108.2 | 1,174.7 |
| Corporates | 13,394.5 | 861.1 | 77.0 |

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### vii) Credit risk mitigation (continued)

**Guarantees and credit derivatives**

Only eligible providers of guarantees and credit derivatives may be recognised in the standardised approach for credit risk. Guarantees issued by corporate entities may only be taken into account if their rating corresponds to A- or better. The guaranteed exposures receive the risk weight of the guarantor.

GIB uses credit derivatives as credit risk protection only to a very limited extent as the credit portfolio is considered to be well diversified.

**Collateral and valuation principles**

The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market/fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. In general, lending is based on the customer's repayment capacity and not the collateral value. However, collateral is considered the secondary alternative if the repayment capacity proves inadequate. Collateral is not usually held against securities or placements.

**Types of eligible collateral commonly accepted**

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees.

### 4.5 Impaired credit facilities and provisions for impairment

Individually impaired financial assets represent assets for which there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the obligation. Objective evidence that a financial asset is impaired may include: a breach of contract, such as default or delinquency in interest or principal payments, the granting of a concession that, for economic or legal reasons relating to the borrower's financial difficulties, would not otherwise be considered, indications that it is probable that the borrower will enter bankruptcy or other financial reorganisation, the disappearance of an active market, or other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. For equity securities classified as available-for-sale, a significant or prolonged decline in fair value below cost is considered in determining whether a security is impaired.

Provisions for impairment are determined based on the difference between the net carrying amount and the recoverable amount of a financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral.

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

### i) Impaired loan facilities and related provisions for impairment

Impaired loan facilities and the related provisions for impairment were as follows:-

| | Gross exposure US$ millions | Impairment provisions US$ millions | Net exposure US$ millions |
|---|---|---|---|
| Corporates | 164.9 | 84.4 | 80.5 |
| Financial institutions | 37.0 | 9.8 | 27.2 |
| **Total** | **201.9** | **94.2** | **107.7** |

The impaired loan facilities were to counterparties in the GCC.

4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

4.5 Impaired credit facilities and provisions for impairment (continued)

ii) Provisions for impairment – loans and advances

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

| | Specific provisions | | | | |
|---|---|---|---|---|---|
| | Corporates US$ millions | Financial institutions US$ millions | Total US$ millions | Collective provisions US$ millions | Total provisions US$ millions |
| At 1st January 2008 | 7.8 | 2.6 | 10.4 | 65.0 | 75.4 |
| Amounts utilised | (2.9) | - | (2.9) | - | (2.9) |
| Charge for the year | 79.5 | 7.2 | 86.7 | 115.0 | 201.7 |
| **At 31st December 2008** | **84.4** | **9.8** | **94.2** | **180.0** | **274.2** |

The increase in collective loan provisions during the year ended 31st December 2008 reflected increases in the expected probabilities of default used in the calculation of provisions for impairment measured on a collective basis. Higher probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment. The probabilities of default applied in the calculation of the collective provisions of impairment at 31st December 2008 equated to a speculative-grade mean default rate of 13.9 per cent, exceeding the previous historical high corporate default levels witnessed in July 1991.

iii) Impaired investment securities and related provisions for impairment

Impaired investment securities and related provisions for impairment were as follows:-

| | Gross exposure US$ millions | Impairment provisions US$ millions | Net exposure US$ millions |
|---|---|---|---|
| Structured investment vehicles (SIVs) | 564.5 | 564.5 | - |
| Equity investments | 95.8 | 68.5 | 27.3 |
| Residential mortgage-backed CDOs | 9.5 | 9.5 | - |
| **Total** | **669.8** | **642.5** | **27.3** |

Total specific impairment provisions of US$642.5 million represented 95.9 per cent of the gross impaired investment securities exposure.

iv) Provisions for impairment – investment securities

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

| | Specific provisions | | | | | | |
|---|---|---|---|---|---|---|---|
| | SIVs US$ millions | Equities US$ millions | CDOs US$ millions | Financial institutions US$ millions | Total US$ millions | Collective provisions US$ millions | Total provisions US$ millions |
| At 1st January 2008 | 500.0 | 24.1 | 206.9 | 2.0 | 733.0 | 252.0 | 985.0 |
| Exchange rate movements | (2.4) | (0.4) | (2.4) | (3.6) | (8.8) | 8.8 | - |
| Amounts utilised | (15.0) | (16.4) | (425.5) | (116.7) | (573.6) | - | (573.6) |
| Charge/(release) for the year | 81.9 | 61.2 | 230.5 | 118.3 | 491.9 | (126.8) | 365.1 |
| **At 31st December 2008** | **564.5** | **68.5** | **9.5** | **-** | **642.5** | **134.0** | **776.5** |

## 4. CREDIT RISK – PILLAR 3 DISCLOSURES (continued)

### 4.6 Past due facilities

In accordance with guidelines issued by the CBB, credit facilities are placed on non-accrual status and interest income suspended when either principal or interest is overdue by 90 days whereupon unpaid and accrued interest is reversed from income. Interest on non-accrual facilities is included in income only when received. Credit facilities classified as past due are assessed for impairment in accordance with the IFRS guidelines as set out in section 4.5 of this report. A specific provision is established only where there is objective evidence that a credit facility is impaired.

#### i) Loans

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

| | Gross US$ millions | Carrying amount US$ millions |
|---|---|---|
| Corporates | 4.0 | - |
| Financial institutions | 2.0 | 1.0 |
| **Total** | **6.0** | **1.0** |

The past due loans were to counterparties in the GCC.

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

| | Less than 1 year US$ millions | 2 to 3 years US$ millions | Over 3 years US$ millions | Total US$ millions |
|---|---|---|---|---|
| Corporates | - | 4.0 | - | 4.0 |
| Financial institutions | - | - | 2.0 | 2.0 |
| **Total** | **-** | **4.0** | **2.0** | **6.0** |

#### ii) Investment securities

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

| | Gross US$ millions | Carrying amount US$ millions |
|---|---|---|
| Residential mortgage-backed CDOs | 9.5 | - |
| **Total** | **9.5** | **-** |

The past due debt securities were past due in relation to interest only and had not yet reached their contractual maturity dates.

### 4.7 Restructured loan facilities

There were no restructured loan facilities during the year ended 31st December 2008.

## 5. MARKET RISK – PILLAR 3 DISCLOSURES

### 5.1 Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk, 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.

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 credit markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities.

### 5.2 VaR model

A key element in the Group’s market risk management framework is the estimation of potential future losses that may arise from adverse market movements. Exposure to general market risk is calculated utilising a VaR model. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the CBB. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at 3.75 by the CBB. The multiplication factor was increased by the CBB from the regulatory minimum of 3.0 during 2008, based on the number of back testing exceptions recorded in the financial year ended 31st December 2007. The trading-related exposures that gave rise to the back testing exceptions in 2007 were liquidated in the three months ended 31st March 2008.

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, the events of 9/11 and the 2007 US subprime crisis. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability repricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile of the various asset and liability categories are set out in section 8 of this report.

For internal risk management purposes, the Group measures losses that are anticipated to occur within a 95 per cent confidence level. Internally, the Group measures VaR utilising a one month assumed holding period for both trading and banking book positions. For regulatory capital adequacy purposes, the figures are calculated using the regulatory VaR basis at a 99 per cent confidence level (2.33 standard deviations) and a ten-day holding period using one-year unweighted historical daily movements in market rates and prices. Correlations across broad risk categories are excluded for regulatory capital adequacy purposes.

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

| | 31.12.08 US$ millions | Average US$ millions | High US$ millions | Low US$ millions |
|---|---|---|---|---|
| Equity risk | 3.8 | 5.8 | 7.6 | 3.8 |
| Interest rate risk | 1.4 | 1.6 | 2.6 | 1.1 |
| Foreign exchange risk | - | 0.2 | 0.9 | - |
| **Total diversified risk** | **4.6** | **7.1** | **9.7** | **4.6** |

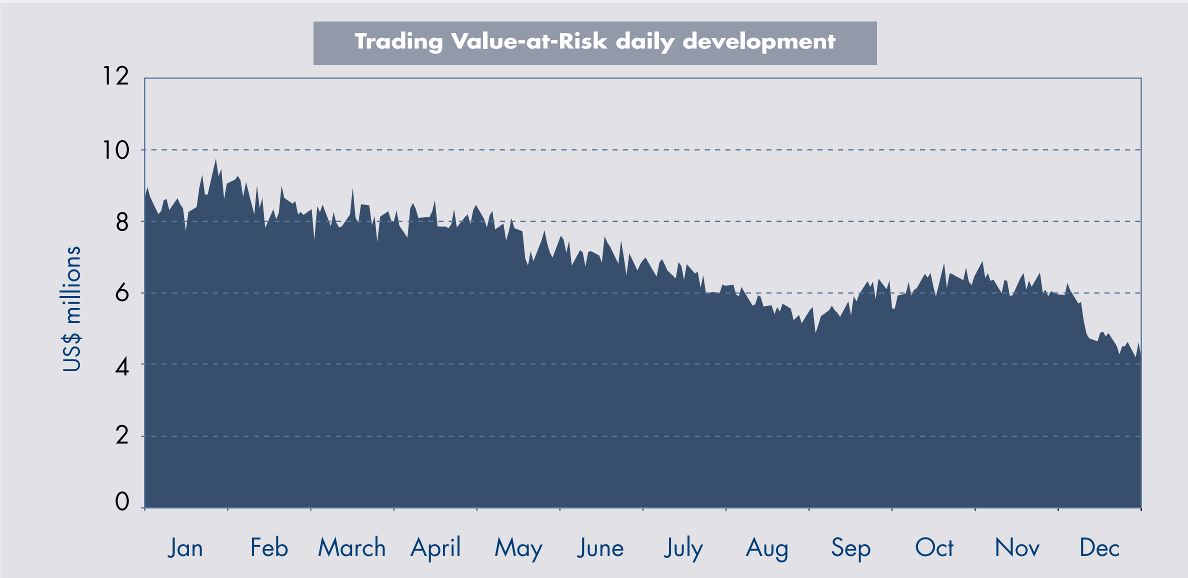
The equity market risk principally related to alternative investment funds managed by external managers.

## 5. MARKET RISK – PILLAR 3 DISCLOSURES (continued)

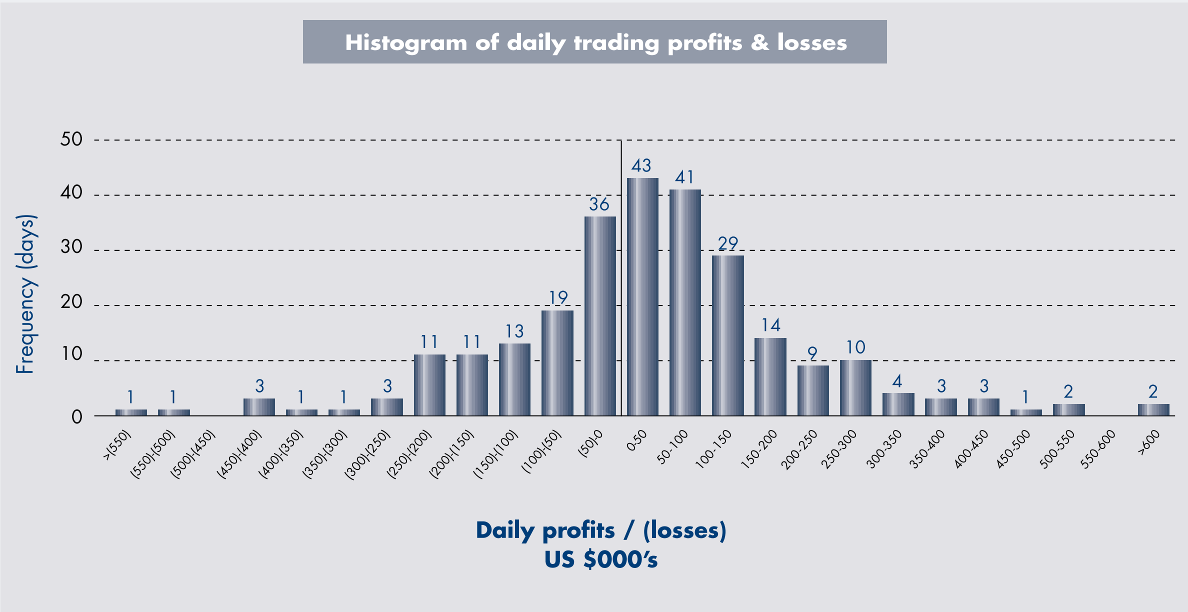
### 5.2 VaR model (continued)

The Group conducts daily VaR back testing both for regulatory compliance purposes and for the internal evaluation of VaR against actual trading profits and losses. During the year ended 31st December 2008, the daily trading loss exceeded the trading VaR at the close of business on the previous business day on only three occasions.

The graph below sets out the total VaR for all the Group's trading activities at the close of each business day throughout the year ended 31st December 2008:-




The daily trading profits and losses during the year ended 31st December 2008 are summarised as follows:-



## 5. MARKET RISK – PILLAR 3 DISCLOSURES (continued)

### 5.3 Sensitivity analysis

The sensitivity of the interest rate risk in the banking book to changes in interest rates is set out in section 8.2(iii) of this report.

The Group is also exposed to the impact of changes in credit spreads on the fair value of available-for-sale debt securities. Credit spread risk is managed within VaR limits and through the use of models to evaluate the sensitivity of changes in equity to movements in credit spreads. Based on the available-for-sale debt securities held at 31st December 2008, a one basis point increase in credit spreads would result in a US$0.6 million decrease in fair value.

## 6. OPERATIONAL RISK – PILLAR 3 DISCLOSURES

### 6.1 Operational risk

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

As part of the Group's Operational Risk Management Framework (ORMF), comprehensive risk self-assessments are conducted, which identify the operational risks inherent in the Group's activities, processes and systems. The controls in place to mitigate these risks are also reviewed, and enhanced as necessary. A database of measurable operational risk events is being developed and maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk.

The capital requirement for operational risk is calculated for regulatory purposes according to the basic indicator approach, in which the Group's average gross income for the preceding three financial years is multiplied by an alpha coefficient of 15 per cent as prescribed by the CBB.

The operational risk capital requirement is based on gross income from the preceding three financial years. Consequently, the operational risk capital requirement is updated only on an annual basis.

## 7. OFF-BALANCE SHEET EXPOSURE AND SECURITISATIONS

Off-balance sheet exposures are divided into two exposure types in accordance with the calculation of credit risk RWAs in the CBB's Basel 2 capital adequacy framework:-

- Credit-related contingent items: Credit-related contingent items comprise guarantees, credit commitments and unutilised approved credit facilities.
- Derivative and foreign exchange instruments: Derivative and foreign exchange instruments are contracts, the value of which is derived from one or more underlying financial instruments or indices, and include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and credit markets

In addition to counterparty credit risk measured within the Basel 2 credit risk framework, derivatives also incorporate exposure to market risk and carry a potential market risk capital requirement, as commented on in more detail in section 5 of this report.

For the two off-balance exposure types, there are different possible values for the calculation base of the regulatory capital requirement, as commented on below:-

### 7.1 Credit-related contingent items

For credit-related contingent items, the nominal value is converted to an exposure at default (EAD) through the application of a credit conversion factor (CCF). The CCF factor is 50 per cent or 100 per cent depending on the type of contingent item, and is intended to convert off-balance sheet notional amounts into an equivalent on-balance sheet exposure.

## 7. OFF-BALANCE SHEET EXPOSURE AND SECURITISATIONS (continued)

### 7.1 Credit-related contingent items (continued)

Credit commitments and unutilised approved credit facilities represent commitments that have not been drawndown or utilised at the reporting date. The nominal amount provides the calculation base to which a CCF is applied for calculating the EAD. The CCF ranges between 0 per cent and 100 per cent depending on the approach, product type and whether the unutilised amounts are unconditionally cancellable or irrevocable.

The table below summarises the notional principal amounts, RWAs and capital requirements for each credit-related contingent category:-

| | Notional principal amount US$ millions | RWA US$ millions | Capital requirement US$ millions |
|---|---|---|---|
| Direct credit substitutes | 334.6 | 283.6 | 34.0 |
| Transaction-related contingent items | 1,147.2 | 440.0 | 52.8 |
| Short-term self-liquidating trade-related contingent items | 546.4 | 89.9 | 10.8 |
| Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities | 1,609.3 | 782.8 | 93.9 |
| **Total** | **3,637.5** | **1,596.3** | **191.5** |

Commitments may be drawndown on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2008, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US$433.8 million.

### 7.2 Derivative and foreign exchange instruments

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management activity to hedge its own exposure to market risk. 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 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.

The aggregate notional amounts for derivative and foreign exchange instruments at 31st December 2008 are set out in note 30 to the consolidated financial statements.

## 7. OFF-BALANCE SHEET EXPOSURE AND SECURITISATIONS (continued)

### 7.3 Counterparty credit risk

Counterparty credit risk is the risk that a counterparty to a contract in the interest rate, foreign exchange, equity and credit markets defaults prior to the maturity of the contract. The counterparty credit risk for derivative and foreign exchange instruments is subject to credit limits on the same basis as other credit exposures. Counterparty credit risk arises in both the trading book and the banking book.

#### i) Counterparty credit risk calculation

For regulatory capital adequacy purposes, GIB uses the current exposure method to calculate the exposure for counterparty credit risk for derivative and foreign exchange instruments in accordance with the credit risk framework in the CBB's Basel 2 capital adequacy framework. Credit exposure comprises the sum of current exposure (replacement cost) and potential future exposure. The potential future exposure is an estimate, which reflects possible changes in the market value of the individual contract during the remaining life of the contract, and is measured as the notional principal amount multiplied by a risk weight. The size of the risk weight depends on the risk categorisation of the contract and the contract's remaining life. Netting of potential future exposures on contracts within the same legally enforceable netting agreement is done as a function of the gross potential future exposure.

The EAD, RWAs and capital requirements for the counterparty credit risk of derivative and foreign exchange instruments analysed by standard portfolio, is presented in the table below:-

| | Exposure at Default (EAD) | | | | |
|---|---|---|---|---|---|
| | Current exposure US$ millions | Future exposure US$ millions | Total exposure US$ millions | RWA US$ millions | Capital requirement US$ millions |
| Banks | 102.7 | 37.9 | 140.6 | 21.6 | 2.6 |
| Corporates | 96.6 | 1.2 | 97.8 | 9.3 | 1.1 |
| **Total** | **199.3** | **39.1** | **238.4** | **30.9** | **3.7** |

#### ii) Mitigation of counterparty risk exposure

Risk mitigation techniques are widely used to reduce exposure to single counterparties. The most common risk mitigation technique for derivative and foreign exchange-related exposure is the use of master netting agreements, which allow the Group to net positive and negative replacement values of contracts under the agreement in the event of default of the counterparty.

The reduction of counterparty credit risk exposure for derivative and foreign exchange instruments through the use of risk mitigation techniques is demonstrated as follows:-

| | Current exposure US$ millions | Effect of netting agreements US$ millions | Netted current exposure US$ millions |
|---|---|---|---|
| Counterparty credit risk exposure | 199.3 | (39.3) | 160.0 |

### 7.4 Securitisations

Securitisations are defined as structures where the cash flow from an underlying pool of exposures is used to secure at least two different stratified risk positions or tranches reflecting different degrees of credit risk. Payments to the investors depend upon the performance of the underlying exposures, as opposed to being derived from an obligation of the entity originating those exposures.

At 31st December 2008, the Group had no exposure, net of specific provisions, to securitisation tranches.

The Group provides collateral management services to five collateralised debt obligations (CDOs) issued between 2002 and 2006. The CDOs are intended to extract relative value from a wide range of asset classes across a broad spectrum of credit ratings. The underlying collateral of the CDOs includes leveraged loans, residential and commercial real estate, consumer finance, lending to small and medium sized enterprises, and other receivables. In order to ensure granularity, each CDO holds between 80 and 140 individual investments providing diversification by size, asset class, industry, geography, credit rating and date of issue.

## 7. OFF-BALANCE SHEET EXPOSURE AND SECURITISATIONS (continued)

### 7.4 Securitisations (continued)

At 31st December 2008 the underlying investments in the CDOs for which the Group acted as collateral manager amounted to US$1.8 billion. At 31st December 2008, GIB did not hold any exposure to CDOs managed by the Group.

The Fitch rating agency reaffirmed the Group's CDO asset manager rating of CAM 2- in May 2008.

## 8. INTERNAL CAPITAL INCLUDING OTHER RISK TYPES

GIB manages and measures other risk types that are not included under Pillar 1 in the CBB's Basel 2 framework. These are principally covered in the Group's internal economic capital model.

This section describes GIB's economic capital model and discusses the treatment of the other risk types that are not addressed in Pillar 1 of the CBB's Basel 2 framework.

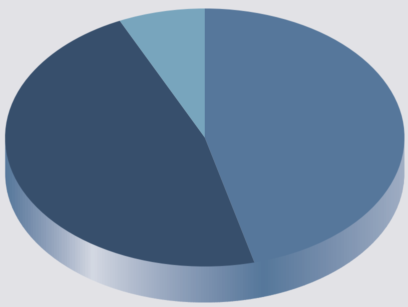
### 8.1 Economic capital model

For many years, GIB has applied economic capital and risk-adjusted return on capital (RAROC) methodologies which are used for both decision making purposes and performance reporting and evaluation.

GIB calculates economic capital for the following major risk types: credit, market and operating risk. Operating risk includes business risk. Additionally, the economic capital model explicitly incorporates concentration risk, interest rate risk in the banking book and business risk.

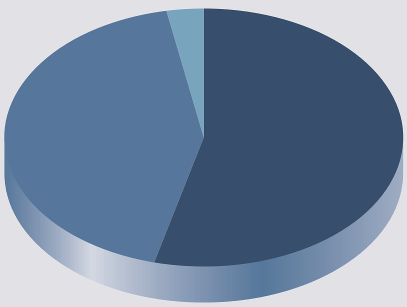
The composition of economic capital by risk type and business unit was as follows:-

**Risk type**



| | % |
|---|---|
| Credit risk capital | 46 |
| Market risk capital | 47 |
| Operating risk capital | 7 |
| **Total** | **100** |

**Business unit**



| | % |
|---|---|
| Treasury | 54 |
| Merchant Banking | 43 |
| Financial Markets | 3 |
| **Total** | **100** |

The primary differences between economic capital and regulatory capital under the CBB's Basel 2 framework are summarised as follows:-

- In the economic capital methodology, the confidence level for all risk types is set at 99.88 per cent, compared to 99.0 per cent in the CBB's Basel 2 framework.
- Credit risk is calculated using GIB's estimates of probability of default, loss given default and exposures at default, rather than the regulatory values in the standardised approach.
- The economic capital model utilises GIB's embedded internal rating system, as described in more detail later in this section of the report, to rate counterparties rather than using the ratings of credit rating agencies or the application of a 100 per cent risk weighting for unrated counterparties.

## 8. INTERNAL CAPITAL INCLUDING OTHER RISK TYPES (continued)

### 8.1 Economic capital model (continued)

- Concentration risk is captured in the economic capital model through the use of an internal credit risk portfolio model and add-on factors where applicable.
- The economic capital model applies a capital charge for interest rate risk in the banking bank.
- The economic capital model applies a business risk capital charge where applicable.

#### Internal rating system

The economic capital model is based on an internal credit rating system. The internal credit rating system is used throughout the organisation and is inherent in all business decisions relating to the extension of credit. A rating is an estimate that exclusively reflects the quantification of the repayment capacity of the customer, i.e. the risk of customer default.

The Group monitors, manages and controls credit risk exposures based on an internal credit rating system that rates individual obligors based on a rating scale from 1 to 10, subject to positive (+) and negative (-) modifiers for rating grades 2 to 6. The internal credit rating is a measure of the credit-worthiness of a single obligor, based on an assessment of the credit risk relating to senior unsecured, medium term, foreign currency credit exposure. The primary objectives of the internal credit rating system are the maintenance of a single uniform standard for credit quality measurement, and to serve as the primary basis for Board-approved risk parameters and delegated credit authority limits. The internal credit rating system also serves as a key input into the Group's RAROC performance measurement system. Ratings are assigned to obligors, rather than facilities, and reflect a medium term time horizon, thereby rating through an economic cycle.

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

| Internal rating grade | Internal classification | Historical default rate range per cent | Fitch and Standard & Poor's | Moody's |
|---|---|---|---|---|
| **Investment grade** | | | | |
| Rating grade 1 | Standard | 0.00 - 0.00 | AAA | Aaa |
| Rating grade 2 | Standard | 0.00 - 0.02 | AA | Aa |
| Rating grade 3 | Standard | 0.05 - 0.07 | A | A |
| Rating grade 4 | Standard | 0.15 - 0.31 | BBB | Baa |
| **Sub-investment grade** | | | | |
| Rating grade 5 | Standard | 0.52 - 1.44 | BB | Ba |
| Rating grade 6 | Standard | 2.53 - 9.06 | B | B |
| Rating grade 7 | Standard | 25.59 | CCC | Caa |
| **Classified** | | | | |
| Rating grade 8 | Substandard | 25.59 | CC | Ca |
| Rating grade 9 | Doubtful | 25.59 | C | C |
| Rating grade 10 | Loss | - | D | - |

The external rating mapping does not intend to reflect that there is a fixed relationship between GIB's internal rating grades and those of the external agencies since the rating approaches differ.

The historical default rates represent the range of probability of defaults (PDs) between the positive and negative modifiers for each rating grade based on Standard & Poor's one year default rates for the 27 years from 1981 to 2007 for senior unsecured obligations. The default rates represent the averages over the 27 year period and therefore reflect the full range of economic conditions prevailing over that period.

## 8. INTERNAL CAPITAL INCLUDING OTHER RISK TYPES (continued)

### 8.2 Other risk types

#### i) Liquidity risk

The Group has established approved limits which restrict the volume of liabilities maturing in the short term. An independent risk management function monitors the future cash flow maturity profile against approved limits on a daily basis. The cash flows are monitored against limits applying to both daily and cumulative cash flows occurring over a 14 day period. The cash flow analysis is also monitored on a weekly basis by the Assets and Liabilities Committee (ALCO).

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

The funding base is enhanced through term financing, amounting to US$2,431.5 million at 31st December 2008. Access to available but uncommitted short-term funding from the Group's established breadth of Middle East and international relationships provides additional comfort. In addition to the stable funding base, the Group maintains a stock of liquid and marketable securities that can be readily sold or repoed.

At 31st December 2008, 64.4 per cent of total assets were contracted to mature within one year. With regard to deposits, retention records demonstrate that there is considerable divergence between their contractual and effective maturities. By way of example, average deposits in the year ended 31st December 2008 from those counterparties with deposits over US$10 million at 31st December 2008 amounted to US$13,081.2 million. This represented 71.7 per cent of total deposits at the year end.

US$12,223.4 million or 66.4 per cent of the Group's deposits at 31st December 2008 were from GCC countries, and a further US$4,213.9 million or 22.9 per cent were from other Middle East and North African countries. Total deposits from counterparties in Middle East and North African countries therefore represented 89.3 per cent of total deposits at 31st December 2008. Historical experience has shown that GIB's deposits from counterparties in the Middle East region are more stable than deposits derived from the international interbank market, which at 31st December 2008 were only US$1,957.7 million, or 10.7 per cent of the Group's deposit base. At 31st December 2008 placements with counterparties in non-MENA countries were 1.8 times the deposits received, demonstrating that the Group is a net lender of funds in the international interbank market.

#### ii) Concentration risk

Concentration risk is the credit risk stemming from not having a well diversified credit portfolio, i.e. the risk inherent in doing business with large customers or being overexposed in particular industries or geographic regions. GIB's internal economic capital methodology for credit risk addresses concentration risk through the application of a single-name concentration add-on.

Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15 per cent of the regulatory capital base. At 31st December 2008, the following single obligor exposures exceeded 15 per cent of the Group's regulatory capital base (i.e. exceeded US$412.2 million):-

| | On-balance sheet exposure US$ millions | Off-balance sheet exposure US$ millions | Total exposure US$ millions |
|---|---|---|---|
| Counterparty A | 718.4 | 152.5 | 870.9 |

This exposure had been approved by the CBB in accordance with the CBB's single obligor regulations. Under the CBB's regulations single obligors include entities in which there is an ownership interest of 20 per cent or more. This is a significantly lower threshold than that used to determine control under IFRS.

#### iii) Interest rate risk in the banking book

Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates.

8. INTERNAL CAPITAL INCLUDING OTHER RISK TYPES (continued)

8.2 Other risk types (continued)

iii) Interest rate risk in the banking book (continued)

The Group does not maintain material foreign currency exposures or equity exposures in the banking book. Equities held in the banking book are commented in more detail in section 4.4(vi) of this report.

In general, the Group's policy is to match financial assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps.

The repricing profile of the Group's financial assets and liabilities are set out in the table below:-

| | 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 |
|---|---|---|---|---|---|---|
| Cash and other liquid assets | 302.0 | 1.0 | - | - | - | 303.0 |
| Placements with banks | 3,662.4 | 75.0 | - | 300.0 | - | 4,037.4 |
| Due from shareholders | 4,832.0 | - | - | - | - | 4,832.0 |
| Trading securities | - | - | - | - | 207.1 | 207.1 |
| Investment securities:- | | | | | | |
| - Fixed rate | 20.0 | 13.4 | 13.5 | 154.5 | - | 201.4 |
| - Floating rate | 1,784.5 | 159.3 | - | - | (134.0) | 1,809.8 |
| - Equities and equity funds | - | - | - | - | 209.3 | 209.3 |
| Loans and advances | 10,610.3 | 2,371.2 | 144.6 | 26.0 | (180.0) | 12,972.1 |
| Other assets | - | - | - | - | 461.4 | 461.4 |
| Total assets | 21,211.2 | 2,619.9 | 158.1 | 480.5 | 563.8 | 25,033.5 |
| Deposits | 17,301.0 | 927.1 | 153.2 | 13.7 | - | 18,395.0 |
| Securities sold under agreements to repurchase | 1,028.0 | 216.8 | - | - | - | 1,244.8 |
| Other liabilities | - | - | - | - | 486.7 | 486.7 |
| Term financing | 2,951.5 | 30.0 | - | - | - | 2,981.5 |
| Equity | - | - | - | - | 1,925.5 | 1,925.5 |
| Total liabilities & equity | 21,280.5 | 1,173.9 | 153.2 | 13.7 | 2,412.2 | 25,033.5 |
| **Interest rate sensitivity gap** | **(69.3)** | **1,446.0** | **4.9** | **466.8** | **(1,848.4)** | **-** |
| **Cumulative interest rate sensitivity gap** | **(69.3)** | **1,376.7** | **1,381.6** | **1,848.4** | **-** | **-** |

The repricing profile is based on the remaining period to the next interest repricing date and the balance sheet categories in the consolidated financial statements.

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 investment security and loan provisions are classified in non-interest bearing items.

The substantial majority of assets and liabilities reprice within one year.

Interest rate exposure beyond one year amounted to only US$480.5 million or 1.9 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 2008 the modified duration of these fixed rate government securities and interest rate swaps was 3.03 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$140,500.

## 8. INTERNAL CAPITAL INCLUDING OTHER RISK TYPES (continued)

### 8.2 Other risk types (continued)

#### iii) Interest rate risk in the banking book (continued)

Based on the repricing profile at 31st December 2008, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent (100 basis points) increase in interest rates across all maturities would result in a reduction in net income before tax for the following year and in the Group's equity by approximately US$7.0 million and US$22.1 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.

#### iv) Business risk

Business risk represents the earnings volatility inherent in all businesses due to the uncertainty of revenues and costs due to changes in the economic and competitive environment.

For economic capital purposes, business risk is calculated based on the annualised cost base of applicable business areas.

## 9. CAPITAL ADEQUACY RATIOS AND OTHER ISSUES

### 9.1 Capital adequacy ratios

The Group's policy is to maintain a strong capital base so as to preserve investor, creditor and market confidence and to sustain the future development of the business. The impact of the level of capital on shareholders' return is also recognised as well as the need to maintain a balance between the higher returns that might be possible with greater gearing and the advantages and security afforded by a sound capital position. The Group manages its capital structure and makes adjustments to the structure taking account of changes in economic conditions and strategic business plans. The capital structure may be adjusted through the dividend payout, and the issue of new shares, subordinated term finance, and innovative tier 1 capital securities.

The capital adequacy ratios of GIB's principal subsidiary, GIBUK, and the Group were as follows:-

| | GIBUK | Group |
|---|---|---|
| Total RWAs (US$ millions) | 739.0 | 15,894.2 |
| Capital base (US$ millions) | 201.5 | 2,747.9 |
| Tier 1 capital (US$ millions) | 201.5 | 1,985.4 |
| **Tier 1 ratio (per cent)** | **27.3%** | **12.5%** |
| **Total ratio (per cent)** | **27.3%** | **17.3%** |

GIB aims to maintain a minimum tier 1 ratio of 8 per cent and a total capital adequacy ratio in excess of 12 per cent. The CBB's current minimum total capital adequacy ratio for banks incorporated in Bahrain is set at 12 per cent. The CBB does not prescribe a minimum ratio requirement for tier 1 capital.

**Strategies and methods for maintaining a strong capital adequacy ratio**

GIB prepares multi-year strategic projections on a rolling annual basis which include an evaluation of short term capital requirements and a forecast of longer-term capital resources.

The evaluation of the strategic planning projections have historically given rise to capital injections. The capital planning process triggered the raising of additional tier 2 capital through a US$400 million subordinated debt issue in 2005 to enhance the total regulatory capital adequacy ratio, and a US$500 million capital increase in March 2007 to provide additional tier 1 capital to support planned medium term asset growth. A further US$1.0 billion capital increase took place in December 2007 to enhance capital resources and compensate for the impact of provisions relating to exposures impacted by the global credit crisis.

## 9. CAPITAL ADEQUACY RATIOS AND OTHER ISSUES (continued)

### 9.2 ICAAP considerations

Pillar 2 in the CBB's Basel 2 framework covers two main processes: the ICAAP and the supervisory review and evaluation process. The ICAAP involves an evaluation of the identification, measurement, management and control of material risks in order to assess the adequacy of internal capital resources and to determine an internal capital requirement reflecting the risk appetite of the institution. The purpose of the supervisory review and evaluation process is to ensure that institutions have adequate capital to support the risks to which they are exposed and to encourage institutions to develop and apply enhanced risk management techniques in the monitoring and measurement of risk.

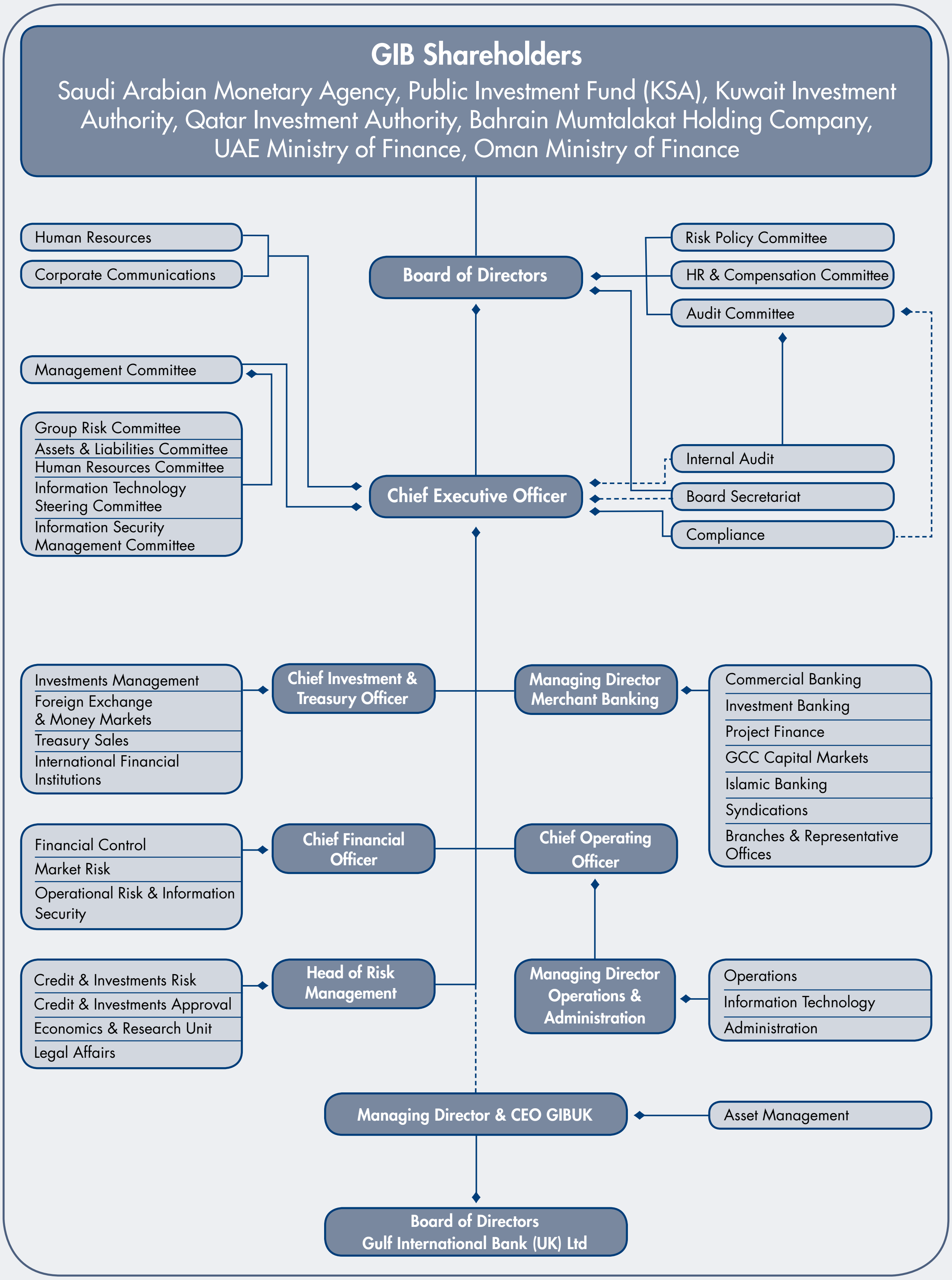
GIB's regulatory capital base exceeded the CBB's minimum requirement of 12 per cent throughout the year ended 31st December 2008. Based on the results of capital adequacy stress testing and capital forecasting, GIB considers that the buffers held for regulatory capital adequacy purposes are sufficient and that GIB's internal minimum capital targets of 8 per cent for tier 1 capital and 12 per cent for total capital are adequate given its current risk profile and capital position. The Group's regulatory capital adequacy ratios set out in section 9.1 of this report significantly exceeded the minimum capital targets and are high by international comparison.

GIB uses its internal capital models, economic capital, and capital adequacy calculations based on the CBB's FIRB approach for credit risk when considering internal capital requirements both with and without the application of market stress scenarios. As a number of Pillar 2 risk types exist within GIB's economic capital framework (i.e. interest rate risk in the banking book, concentration risk and business risk), GIB uses its existing internal capital measurements as the basis for determining additional capital buffers. GIB considers the results of its capital adequacy stress testing, along with economic capital and RWA forecasts, to determine its internal capital requirement and to ensure that the Group is adequately capitalised in stress scenarios reflecting GIB's risk appetite.

## 10. GLOSSARY OF ABBREVIATIONS

| | |
|---|---|
| **ALCO** | Assets and Liabilities Committee |
| **AMA** | Advanced Measurement Approach |
| **Basel Committee** | Basel Committee for Banking Supervision |
| **CBB** | Central Bank of Bahrain |
| **CCF** | Credit Conversion Factor |
| **CDO** | Collateralised Debt Obligation |
| **CEO** | Chief Executive Officer |
| **CFO** | Chief Financial Officer |
| **CI & TO** | Chief Investment and Treasury Officer |
| **EAD** | Exposure at Default |
| **FIRB Approach** | Foundation Internal Ratings Based Approach |
| **FSA** | Financial Services Authority (of the United Kingdom) |
| **GCC** | Gulf Cooperation Council |
| **GIB** | Gulf International Bank B.S.C. |
| **GIBUK** | Gulf International Bank (U.K.) Limited |
| **The Group** | Gulf International Bank B.S.C. and subsidiaries |
| **ICAAP** | Internal Capital Adequacy Assessment Process |
| **IFRS** | International Financial Reporting Standards |
| **LGD** | Loss Given Default |
| **MD RM** | Managing Director - Risk Management |
| **MENA** | Middle East and North Africa |
| **ORMF** | Operational Risk Management Framework |
| **PD** | Probability of Default |
| **PSE** | Public Sector Entities |
| **RAROC** | Risk-adjusted Return on Capital |
| **RMBS** | Residential Mortgage-Backed Securities |
| **RWA** | Risk Weighted Amount |
| **SIV** | Structured Investment Vehicle |
| **VaR** | Value-at-Risk |

# Organisation and Corporate Governance Chart



# Biographies of the Board and Senior Management

## BOARD OF DIRECTORS

**H.E. Mr. Jammaz bin Abdullah Al-Suhaimi**
Chairman
Saudi Arabian Citizen
H.E. Al-Suhaimi holds a Bachelor's degree in Electrical Engineering from the University of Washington in Seattle, USA. He joined GIB as Chairman of the Board of Directors in 2008. Prior to that, he served between 2004 and 2006 as Chairman and Chief Executive of the Capital Market Authority, the regulatory body for the capital market in the Kingdom of Saudi Arabia. During the period 1989-2004, he was Deputy Governor of the Saudi Arabian Monetary Agency. He initially joined SAMA as Director-General for Banking Control. He had also held various senior management positions in the government including that of Deputy Director General of the Saudi Industrial Development Fund (1982-1984). H.E. Al-Suhaimi has held Board memberships in many leading public and private organisations such as the Saudi Arabian General Investment Authority, the General Petroleum and Minerals Organisation, the National Company for Cooperative Insurance and the London-based Saudi International Bank (which merged with GIB in 1999).

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

**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 bin Nassir Al-Shukaily** ❶ ❸
Omani Citizen
BS in Business Administration from USA and MA in Development Management, the 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, Director of the Minister's Office at the Ministry of National Economy and Director of the Minister's Office at the Ministry of Civil Services. He is also Deputy Chairman of the Board of Oman Refinery Company, Oman Airport Management Company and Qatar-Oman Investment Company. He is a Board Member of Sohar Industrial Port Company and Dubai Mercantile Exchange.

**Dr. Khalid A. Al-Sweilem** ❶ ❷ 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-Sowaidi** ❷ ❸
Qatari Citizen
BA in Accounting from South Eastern University, United Kingdom. He joined the Board in 2004. He 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 of the Executive Board Member to 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 for Development and Institutional Support at the Ministry of Economy. He previously served as Director of Exports Promotion at the Ministry of Economy. Prior to this he was 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.

**H.E. 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 (Texas A&M), 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. In 2007 he was appointed Governor of the Communications & Information Technology Commission in the Kingdom of Saudi Arabia. He is a member in the Academy of Management and a member of the Institute of Decision Sciences. Dr. Al-Jafary is Board member of the Saudi Arabian Mining Company and Dar Al Youm Press and Publishing. He has numerous published researches and lectures.

**Mr. Ahmed Tahous Al-Rashed Al-Tahous** ❶ ❸
Kuwaiti Citizen
Bachelor of Business in Economics, Kuwait University, 1981. He was appointed to the Board of Directors in 2007. Currently he is Director of the Equities Department (America, Europe and Asia) at the Kuwait Investment Authority. Prior to this position, he was Senior Investment Manager (US Equity). Between 1984-1988, he worked at Morgan Stanley Asset Management in New York as a Portfolio Manager. Mr. Al-Tahous started his career with Kuwait Investment Authority in 1982. He is a Board Member of the Kuwait Real Estate Investment Consortium (k.s.c.).

**Mr. Khalil Nooruddin** ❸
Bahraini Citizen
A Chartered Financial Analyst, Mr. Nooruddin holds a Bachelor of Science degree in Systems Engineering from the University of Petroleum and Minerals, KSA, and a Master of Science degree in Quantitative Analysis and Finance from Stern Business School at New York University. He joined GIB's Board of Directors in 2008. Mr. Nooruddin is the founder and the Managing Partner of Capital Knowledge, a financial consultancy and training company based in Bahrain. He served as the Director of the Bahrain Institute of Banking and Finance from 2004-2007. Prior to that, he worked for 20 years as a corporate and investment banker. His last assignment was with Investcorp Bank where he served as a member of the Management Committee for 10 years. Earlier he worked as a corporate banker with Chase Manhattan Bank in Bahrain and as an investment banker with Chase Investors Management Corporation and UBS Asset Management in London and Zurich. He also worked for five years as an operations research analyst with Bahrain Petroleum Company and Caltex Petroleum Corporation in New York. Mr. Nooruddin is a Board Member of Ithmaar Bank and Vice Chairman of Alpine Wealth Management. He is also an active member of several civil and professional societies in Bahrain.

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

## SENIOR MANAGEMENT

**Dr. Yahya bin Abdullah A. Alyahya**
Chief Executive Officer
Saudi Arabian Citizen
Dr. Alyahya served on the Board of The World Bank Group as Executive Director representing Saudi Arabia from 1999 to 2006. During that period he served in many capacities, most notably as Dean of Executive Directors and Chairman of the Board Steering Committee (03-06); Chairman of the Personnel Committee and Member of the Budget Committee (02-03); Vice Chairman of the Audit Committee and Member of the Governance Committee (00-02). Prior to that Dr. Alyahya served as Advisor to the Governor, Saudi Arabian Monetary Agency (99); General Manager of E.A. Juffali & Bros. in Riyadh (94-99); Founder and Director General, The Institute of Banking, SAMA, in Riyadh (89-94); Professor of Industrial and Systems Engineering at King Saud University, Riyadh (86-89) and the University of Michigan, USA (83-86); Lecturer on Matching Problems and Algorithms at the Indian Statistical Institute, Bangalore, India (82); and a Project Analyst at the Saudi Industrial Development Fund, Riyadh (75). Dr. Alyahya has also served on the Boards and Board Committees of many organisations, most notably Saudi Re (first reinsurer in SA) (07-08), Gulf Investment Corporation (GIC) (06-08), National Commercial Bank (NCB) (08), Gulf International Bank (GIB) (99-01); Saudi Engineering Society (79-99); Audit Committee of AlBank AlSaudi AlFaransi (97-99) and Saudi Agricultural Bank (92-95). Dr. Alyahya holds a Ph.D in Industrial and Systems Engineering from The University of Michigan, Ann Arbor (83) and a Graduate of the UPM (75). Currently, Dr. Alyahya is Chief Executive Officer of Gulf International Bank (GIB) since January, 2009. He also chairs the Board of Shuaibah Water and Electricity Company (first IWPP in SA), and sits on the Board of Oger Telecom.

**Mr. Abbas Ameeri**
Managing Director-Merchant Banking
Bahraini Citizen
Mr. Ameeri has banking experience of 25 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. Antoine Dijkstra**
Managing Director-Chief Investment and Treasury Officer
Dutch Citizen
Mr. Dijkstra graduated in Economics at the Erasmus University Rotterdam and completed his doctorates at the same institution. He also attended the executive course at INSEAD (France) in 2005. He joined GIB in 2008 as Managing Director and Chief Investment & Treasury Officer. Between 2006 and June 2008, he was a Senior Managing Director at Bear Stearns International in London. He is also a member of the Supervisory Board at Brink's NV, a member of the Board of the Trust Fund of the Erasmus University Rotterdam and member of the Board of Zegora Investments in Zurich. Between 2000 and 2006, he was a member of the Managing Board of NIB Capital NV in the Netherlands with responsibility for the Strategic Business Units Financial Markets, Real Estate Markets, Investment Management and Wealth Management. He is also former member of the Board of Harcourt Investment Consulting.

**Mr. Stephen Williams**
Managing Director-Chief Financial Officer
UK Citizen
Chartered Accountant, Member of the Institute of Chartered Accountants in England and Wales (ICAEW). BSc Economics, University College Cardiff, UK. Mr. Williams joined GIB in 1987. He was appointed Group Financial Controller in 2000 and Chief Financial Officer in 2008. He is directly responsible for Groupwide statutory, regulatory and management reporting; strategic, financial and balance sheet planning; day-to-day market, operational and liquidity risk management; and information security. Mr. Williams was responsible for GIB's Basel 2 implementation project and was a member of the Institute for International Finance's (IIF) Working Group on Capital Adequacy. Mr. Williams is a member of GIB's Management Committee, Group Risk Committee, Assets and Liabilities Committee, Information Systems Committee, and is the chairman of the Information Security Committee and Operational Risk Committee. Prior to joining GIB, Mr. Williams worked for KPMG in London and the Middle East.

**Mr. Richard David Scott**
Managing Director-Head of Risk Management
UK Citizen
Master's degree in Modern History from Oxford University. He joined GIB as Managing Director-Head of Risk Management at its headquarters in the Kingdom of Bahrain in 2008. Mr. Scott worked with Citicorp/Citigroup between 1977 and 2007, most recently as the Region Head for Country Risk Management in Europe, the Middle East and Africa. Prior to this he worked as Risk Manager for the Smith Barney Private Equity Finance business for the Asia Pacific region and Europe (2005-2006). Earlier, Mr. Scott was also the Director and Head of the Investment Finance Business platform of Citibank Private Bank London (2003-2005), and at Saudi American Bank he was the Senior Credit Officer (seconded from Citibank) covering the Central and Western regions, Energy, Public Sector and Financial Institutions (1999-2003). Before joining Samba, Mr. Scott was Citibank's Country Risk Manager in Russia (1996-1999).

**Mr. Hassan Abdul Ghani**
Managing Director-Operations and Administration
Bahraini Citizen
Mr. Abdul Ghani joined GIB more than 30 years ago, where he worked within various departments and business units and headed the Singapore Branch. He completed many specialised and advanced training programmes in credit and operations, including the Darden Executive Management Programmes from the University of Virginia, USA. Mr. Abdul Ghani was appointed Managing Director in 2007, and his responsibilities cover the Bank's operations, information technology, human resources and administration services. Prior to that, Mr. Abdul Ghani served as head of the Human Resources Group, GCC Branches & Syndications, Financial Institutions and other areas. Mr. Abdul Ghani is a member of GIB's Management Committee, the Group Risk Committee, the Human Resources Committee, the IT Committee and the Information Security Committee.

**Mr. Mohab Naji Mufti**
Managing Director and CEO, GIBUK
Saudi Arabian Citizen
BSc Computer Science, University of East Anglia, UK. Mr. Mufti was appointed in 2008 Managing Director and CEO of Gulf International Bank (UK) Ltd. He has been responsible for GIB's Financial Markets business since 1999. He joined Gulf International Bank (UK) Limited in 1996. Prior to that Mr. Mufti worked with the National Commercial Bank in Saudi Arabia, where he was the Head of Trading. Between 1987 and 1993 he occupied various senior trading and investment roles within Saudi International Bank in London. Mr. Mufti is a Board member of the Arab Bankers Association, UK.

# Corporate Directory

## General Management

**Dr. Yahya A. Alyahya**
Chief Executive Officer
**Abbas Ameeri**
Managing Director - Merchant Banking
**Antoine Dijkstra**
Managing Director - Chief Investment & Treasury Officer
**Stephen Williams**
Managing Director - Chief Financial Officer
**Richard David Scott**
Managing Director - Risk Management
**Hassan Abdulghani**
Managing Director - Operations & Administration
**Mohab N. Mufti**
Managing Director & CEO - GIBUK

## Merchant Banking

*GCC Relationship Management*
**Ali Rahimi**
Head of GCC Relationship Management
**Ali Al-Derazi**
Head of Bahrain, Kuwait & Saudi Arabia
**Ali Abdul Wahab**
Head of Oman & Qatar

**Fadel Al Meer**
Country Head - Saudi Arabia and Riyadh Branch Manager
**Haroon Alireza**
Jeddah Branch Manager

*Project Finance & Advisory*
**M. Chandrasekaran**
Head of Project Finance & Advisory
**Ravi Krishnan**
Structuring & Project Advisory
**Tarun Puri**
Project Finance
**Rajan Malik**
Syndications

*GCC Capital Markets*
**Srinivas Vemparala**
Head of GCC Capital Markets, Private Equity & Islamic Banking
**Iftikhar S. Ali**
Islamic Banking
**P. R. Suresh**
GCC Capital Markets
**Maneesh Ajmani**
GCC Private Equity

*International Banking*
**Asghar Ali Baba**
Head of International Banking
**Charbel Khazen**
London Branch
**Gregga Baxter**
New York Branch
**Hassan Yaseen**
Beirut Representative Office

*Investment Banking*
**Oscar Silva**
Head of Investment Banking
**Fakhre Fazli**
Corporate Finance - GCC

## Asset Management

**Robert Sargent**
Head of Asset Management
**Uday Patnaik**
Senior Investment Officer
**Alex Gracian**
Equity Portfolio Management
**James Taylor**
Bond Portfolio Management
**Azhar Hussain**
Fund Products
**Andrew Burgess**
Structured Products
**Anthony Chisnall**
Investor Relations Officer

## Treasury

**Abdulla Haji**
Head of Money Markets & FX
**Marc The**
Head of Sales & Trading
**Adnan Al-Rifaie**
Head of Riyadh Treasury
**Steven Moulder**
Head of London & New York Treasuries
**Ali Al-Qaseer**
Head of International Financial Institutions
**Austin Sequeira**
Head of Treasury Policy & Administration

## Risk Management & Finance

**Masood Zafar**
Chief Credit Officer
**Robert Amis**
Chief Financial Officer - GIBUK
**Russel Bennett**
Head of Financial Management
**Rahul Thomas**
Head of Market Risk
**Michael Cowling**
Head of Information & Operational Risk
**Shane Panjavani**
Operational Risk - Bahrain
**Jameel Al-Sairafi**
Information Security - Bahrain

## Support Functions

**Ali Buhejji**
Operations - Bahrain
**Ali Ashoor**
Administrative Services - Bahrain
**Dimitri Varvitsiotis**
IT Applications - Bahrain
**Ebrahim Al-Rafaei**
IT Operations - Bahrain
**Rashed Abdul-Rahim**
Operations & Administration - Saudi Arabia
**David Maskall**
Operations - GIBUK

## Human Resources

**Hassan Abdulghani**
Head of Human Resources
**Darshan Singh**
Human Resources Development
**Jamal Hejris**
Human Resources - Bahrain

## Audit, Legal & Compliance

**Hassan Al-Mulla**
Group Chief Auditor
**Julian Anthony**
Audit - London
**Vernon Handley**
Legal Counsel - Bahrain
**Georges Djandji**
Head of Compliance - Bahrain
**Toby Billington**
General Counsel & Head of Corporate Office/Company Secretary - London

## Corporate Communications

**Abdulla Naneesh**
Head of Corporate Communications

## Board Secretariat

**Faiz Al-Barwani**
Secretary to the Board

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C/o New York Branch

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