2002

GULF INTERNATIONAL BANK

Annual Report & Accounts

GIB

بنك الخليج الدولي

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GULF INTERNATIONAL BANK

GULF INTERNATIONAL BANK (GIB) IS A LEADING MERCHANT bank in the Middle East with its principal focus on the Gulf Cooperation Council (GCC) states. With a proven track record spanning more than 25 years, GIB provides client-led, innovative financial products and services. Its client base includes major private-sector corporations, Gulf-based financial institutions, multinational companies active in the region and the governments of the GCC states.

GIB has gained an international reputation for project and trade finance and is a leading player in the regional syndicated loan market. The bank's financial strength is based on conservative asset and liability management policies, its high-quality asset profile and strong capital base. More recently, the bank increased its focus on merchant banking services, including corporate finance and asset management.

GIB was established in the Kingdom of Bahrain in 1975 and commenced operations in 1976. The six GCC governments, Bahrain, Kuwait, Qatar, Oman, Saudi Arabia and the United Arab Emirates, own 72.5 per cent of the bank, while the Saudi Arabian Monetary Agency (SAMA) and J. P. Morgan Overseas Capital Corporation own 22.2 per cent and 5.3 per cent respectively. In addition to its main subsidiary Gulf International Bank (UK) Limited, the Bank has branches in London, New York and Riyadh, in addition to representative offices in Beirut and Abu Dhabi.

GIB
بنك الخليج الدولي

THE GULF'S OWN MERCHANT BANK

FINANCIAL HIGHLIGHTS

	2002	2001	2000	1999	1998*
EARNINGS (US$ millions)					
Net Income after Tax	**85.3**	100.5	118.1	67.6	82.1
Net Interest Revenue	**195.7**	193.4	169.7	139.6	115.3
Other Income	**88.4**	70.3	127.3	77.4	49.2
Operating Expenses	**115.6**	118.1	132.3	109.9	52.9
FINANCIAL POSITION (US$ millions)					
Total Assets	**16,236.5**	15,232.0	15,119.5	15,679.4	10,209.0
Available-for-Sale Securities	**8,280.4**	7,641.7	7,062.1	5,451.4	3,229.6
Loans	**3,255.8**	3,309.4	3,923.1	4,038.0	4,000.7
Shareholders' Equity	**1,128.2**	1,193.7	1,205.8	1,137.7	731.0
RATIOS (Per cent)					
PROFITABILITY					
Return on Average Shareholders' Equity	**7.3**	8.4	10.1	6.5	11.2
Return on Average Assets	**0.5**	0.7	0.8	0.5	0.8
CAPITAL					
BIS Risk Asset Ratio					
Total	**12.8**	12.6	11.5	12.2	11.9
Tier 1	**10.3**	10.2	10.2	10.9	10.7
Shareholders' Equity as % of Total Assets	**6.9**	7.8	8.0	7.3	7.2
ASSET QUALITY					
Securities as % of Total Assets	**58.4**	56.8	49.8	38.2	33.0
Loans as % of Total Assets	**20.1**	21.7	25.9	25.8	39.2
LIQUIDITY					
Liquid Assets Ratio	**77.9**	75.1	71.0	71.3	59.1
Deposits to Loans Cover (times)**	**3.6**	3.6	3.1	3.0	2.2

* GIB only (prior to acquisition of GIB (UK) Limited)
** Deposits include Term Financing

BOARD OF DIRECTORS

H.E. Sh. Ebrahim Bin Khalifa Al Khalifa
Chairman
Undersecretary, Ministry of Finance and National Economy
Kingdom of Bahrain

Mr. Abdul Aziz M. Al-Abdulkader
Vice Chairman
President, AMA Group
Kingdom of Saudi Arabia

Mr. Bader Abdullah Al-Rushaid Al-Bader
Ex-Chairman and Managing Director
Kuwait Investment Company
State of Kuwait

Dr. Hamad S. Al-Bazai
Deputy Minister for Economic Affairs
Ministry of Finance and National Economy
Kingdom of Saudi Arabia

Mr. Mohammed Mughnem Al-Shumrani
Director General of Investment Department
Saudi Arabian Monetary Agency
Kingdom of Saudi Arabia

Mr. Saker Dhaher Al-Moraikhi
Consultant, the Minister's Office
Ministry of Finance
State of Qatar

Mr. Mohammed Bin Saif Al-Shamsi
Consultant, the Minister's Office
Ministry of Finance and Industry
United Arab Emirates

Mr. Saud Nassir Al-Shukaily
Director General of Revenue and Investments
Ministry of Finance
Sultanate of Oman

Mr. Mark Stephen Garvin
Managing Director
J. P. Morgan Chase Bank
United Kingdom

''When you're planning a new pipeline, the last thing you want to worry about is liquidity.''

CHAIRMAN'S STATEMENT

EBRAHIM BIN KHALIFA AL KHALIFA
CHAIRMAN

ON BEHALF OF THE BOARD OF DIRECTORS, I am pleased to present the annual report of Gulf International Bank B.S.C. (GIB) for the year ending 31st December 2002. Following on the celebrations of GIB's 25th anniversary, the focus of activities in 2002 was on successfully furthering the campaign for strategic change and development of GIB's merchant banking potential. In the light of continuing poor economic conditions in the industrialised world, the decision to re-orientate the Bank's business has proven to be timely and in the best interests of GIB, its shareholders and the regional economies. In the course of 2002, the major international rating agencies all re-affirmed GIB's long and short term ratings, an encouraging indication of market acceptance of GIB's sound overall prospects and an increasingly important determinant of future business potential.

Global economic and financial conditions deteriorated for a third successive year in 2002 and by a greater margin in many respects than in previous years. Despite aggressive monetary easing by many of the world's leading central banking authorities, world economic growth and major multinational corporate earnings remained discouragingly slow to respond. International investor confidence was shaken further by a series of very large corporate bankruptcies that exposed serious shortcomings in assumed standards of business ethics, supervisory agencies' authority, the reliability of accounting standards and audits and in general levels of governance and compliance. The ensuing nervousness led to almost unprecedented levels of volatility and further price falls across most of the world's largest stock and corporate bond markets.

The GCC economies could not be expected to remain unaffected by these negative worldwide developments, but they have shown considerable resilience and stability. The determination of the Gulf governments and the private sector to continue developing the region's productive resources, infrastructure and social services was evidenced by a steady flow of contracting work and financing opportunities. Even more significant for future prospects were the wide range of new and positive government initiatives and legislation adopted.

The enabling environment for privatisation in the GCC was strengthened in several states in 2002 by the passing of new laws and the establishment of utility sector regulatory bodies to implement liberalisation and to monitor the relevant sectors and the competitive environment. The privatisation process itself achieved real momentum at the end of the year with the successful flotation of 30% of Saudi Telecom Company, the first major transaction of this kind in the Kingdom of Saudi Arabia since 1984. GIB acted as the exclusive advisor on this privatisation to the Public Investment Fund, the Saudi Arabian Government's investment vehicle. As a result, the Bank's merchant banking credentials, expertise and aspirations were further enhanced. It is envisaged that this landmark deal will provide a platform for greater GIB involvement in privatisations and other important developments in the GCC.

As with the GCC economies, GIB was able to protect itself in 2002 from the impact of global economic problems. Full-year consolidated results show that profitably was comfortably maintained, although net income after provisions declined by 15%. The drop in income was accounted for by increased provisions and would have been greater but for the earlier decision to cut back radically on GIB's international presence and exposures, and gradually to redirect the emphasis of the proprietary trading activities. A 5% reduction in shareholders' equity, net of current year income, is accounted for by an adjustment to the fair value of the Bank's available-for-sale securities portfolio as required under International Accounting Standard (IAS) 39 adopted in January 2001. Future easing of credit conditions or concerns in international corporate bond markets can be expected to allow for a considerable recouping of this book adjustment. However, as significant growth in this asset class forms an important feature of GIB's new balance sheet strategy, there is no room for complacency.

Certain components of GIB's performance in 2002 do, however, indicate that future income vulnerability is in the process of being reduced or more tightly controlled in a new business mix that continues to produce strong revenue streams and meets key client requirements. The trend to emphasise non-interest and merchant banking income over interest spread income gained momentum and there was significant growth in asset management activity. The reduction of international lending volumes leaves GIB well positioned to respond to more comprehensive financing and advisory opportunities related to GCC economic development projects. Group-wide expenses were also contained at prior year levels. Most importantly, GIB's capital strength remains fully sufficient to support its future strategy and intended role in the GCC. Furthermore, the performance of the GCC economies in 2002 also confirms a capacity to provide more stable and predictable opportunities for GIB's broader range of services.

Maintaining market confidence, producing stable year-on-year financial performances and minimising vulnerability to risks and external shocks are key conditions of the success of GIB's new strategy. Considerable management time and money is allocated to accessing or retaining the necessary experience, skills and systems to ensure state-of-the-art status in these areas. GIB prides itself on playing a leadership role in setting new standards in financial reporting and market risk management in the region. During 2002, GIB also further developed its understanding of contingency planning by introducing, updating and testing its plans.

Another important development in the strengthening of GIB's overall governance and risk control was the establishment of three further Board sub-committees in addition to the Audit Committee. These are the Executive Committee, the Risk Committee and the Compensation Committee. These new committees streamline the work of the Board of Directors in key areas.

In conclusion, and in the face of challenging times for GIB, I should like to express my appreciation on behalf of the Board of Directors for the continued support of GIB's shareholders, for the skills and dedication of GIB's highly experienced management and staff, and for the constructive cooperation which GIB enjoys with the regulatory authorities that supervise and facilitate its activities.

E. Khalifa

Ebrahim Bin Khalifa Al Khalifa
Chairman

"The one thing all my clients have in common is their success. Otherwise, I'm amazed at how individualistic they are."

MANAGEMENT REVIEW

THE TROUBLED GLOBAL BUSINESS environment prevailing in 2002 provided challenging conditions for GIB's management and its client base at large. Guided by its new and robust medium-term strategy, and assisted by a resilient performance in the GCC economies, GIB continued nevertheless successfully to expand its business and product lines in key markets. Momentum is being carried over into 2003 by the closing of major transactions over the year-end period and by an active pipeline of projects and new initiatives already brought to an advanced stage of development during 2002.

Economic and Business Overview

High levels of uncertainty and crisis prevailed across financial markets during most of 2002. After a decade or more in which governments had increasingly looked to borrow from the best practices of the market and corporate entrepreneurship in their efforts to boost global wealth and welfare, this process and its underlying assumptions were most abruptly challenged. The ensuing sense of loss of direction in international economic management, coupled with the real damage inflicted by the financial crises and bankruptcies that occurred during 2002, led to exaggerated market volatility and serious retreats in investment confidence and outlays.

GIB's management has little reason to doubt that growth, investment and liquidity will recover within a reasonably short period of time and with the fundamentals of the market economy model firmly re-asserted. In the interim, however, the observable reaction of most of the international business community has been to concentrate on core businesses and markets, to limit new investment and to prioritise the protection of capital and earnings. The smoothness with which such restructurings were managed has depended on the strength of strategy of individual companies and the degree of understanding and control they had of their businesses.

For GIB and other GCC businesses and governments, the process of adjustment in 2002 tended to be less dramatic and contagious across sectors than elsewhere. Higher average oil prices during the year supported government budgets and allowed ministries to proceed to the tendering and implementation of capital projects that had become more urgent following successive prior years of tighter fiscal conditions. Expansion activity in the GCC states' key oil, gas, petrochemical and basic metals industries has shown itself to be only marginally sensitive to short-term market conditions and much more determined by unassailable comparative advantage and the drive to add value through greater upstream-downstream integration. Gulf private sector construction, services and trading businesses continued to develop and upgrade new facilities, considerably protected by the non-cyclical economic forces of high per capita personal income, high population growth rates and a very youthful demographic profile.

Although less direct and less damaging, the impact of global economic unease was nevertheless registered in the GCC region. Uncertainties and last-minute changes were introduced into many contractual negotiations as prices and margins on financial products and physical goods fluctuated markedly. Complex tender or concession negotiations were interrupted or put on hold as international counterparties confronted crises elsewhere in their networks. Foreign financial institutions re-assessed their presence in the region as part of their worldwide restructuring efforts. For those private and institutional Gulf investors active in the international financial markets, there were many more direct setbacks to confront, and one noticeable response was a growing preference for locally-based and more conservative fund management. In general, the international environment exerted a clearly discernible but relatively mild restraining influence on Gulf economic activity in 2002.

GIB's early 2001 strategic decision to concentrate on its core regional markets through its new GCC merchant bank mandate was taken well prior to the international economic and financial market turmoil of the past year. The main reason for the shift in business emphasis was the requirement to ensure that the merger with the London-based Saudi International Bank produced the most effective 'One Bank' product line and market positioning under the GIB franchise over the longer term. There had also been a growing realisation over the years that aspects of GIB's non-GCC international business presented an imbalanced risk/reward profile and too many situations where GIB's leverage was minimal. The run-offs in such exposures initiated over the past eighteen months reduced potential losses considerably during 2002. With its long-term commitment to GCC economic development, GIB's new business strategy was also built upon a financial model that allowed for suitably flexible and long lead-times for investment gains on new banking initiatives to be realised. Developments in 2002 have not altered that perspective; nor have they challenged the conviction that GIB's merchant banking expertise will yield the higher risk-adjusted returns needed to secure GIB's future on a sound and consistently profitable basis.

During 2002, GIB continued to be a very prominent player in the GCC markets, not only in terms of its more visible new lending and advisory activities, but also in the servicing, refinancing and restructuring of existing exposures to sustain the quality and flow of business from GIB's more established client base. Increased cross-selling of lending, treasury and merchant banking products broadened key GCC business relationships across a growing spread of different member states and regions, and represented an important early achievement of the new strategy. Changes in market conditions saw improvements in basic pricing, greater demand for a range of hedging and capital protection instruments, and some easing of competitive pressures.

Relationship Management, Project and Structured Finance and Syndications

GIB's determination to ensure that its banking activities further the cause of Gulf economic development, represent controllable risk and produce an acceptable all-in yield in both nominal and risk-adjusted terms has placed emphasis on selectivity as far as client choice is concerned and on product diversification and design. The process of more targeted client marketing is enshrined in the concept of relationship management, both within the GCC and throughout the international network. And in order to forge and maintain broad-based and high level banking ties with its chosen customer base, GIB has to be able to deliver a wide range of banking products on demand, from trade finance and commercial lending through more complex advisory and structuring mandates to asset management and sophisticated money market and treasury services. In organisational terms, the marketing focus is split between GCC relationship management and international corporate relationship management.

The GCC is covered by GIB's head office team, the Riyadh branch, and the Abu Dhabi representative office, which added a small corporate finance team in 2002 to boost marketing and execution capacity in the lower Gulf region. In 2003, the Riyadh branch will take further responsibility for business in Saudi Arabia, adding the Western Province to the Central Province to increase its geographical coverage. Judging by the marketing successes achieved in the Central Province since GIB opened its first Saudi branch in 2001, the move to bring closer physical links with Western Province operations should also assist greater market penetration and enhanced client service. Corporate, sovereign and project lending opportunities were numerous in 2002 and GIB secured leading roles in the arrangement, underwriting and syndication of large facilities in these categories in each of the GCC states. An innovative commodity-backed fixed rate financing was developed to cover part of the financing package for a major aluminium production capacity expansion project. Islamically structured tranches of larger financings also enjoyed popularity as borrowers looked to diversify funding sources and to benefit from the longer maturities that are frequently available in this increasingly mature sector.

Project finance initiatives, particularly in the Abu Dhabi and Qatari water desalination and power sectors, remained prominent with long-term financing transactions in these cases relying primarily on the private developer companies' management capacities and project performance and the off take commitments of sovereign-backed utility entities. Other regional borrowers were encouraged by improved country credit ratings and attractive export credit agency (ECA) terms to structure their capital investment programmes through a more direct contracting approach. Past involvement in the various types of financing structures under consideration, together with good relationships with all the major players and institutions in these markets, enabled GIB to offer the flexibility and range of choices demanded by its clients.

Internationally, the more selective approach to business has resulted in a reduction in non-core activity out of the London and New York branches of GIB. The business of the former representative office in Singapore is being managed out of Bahrain and generally run off. GIB maintains relationships only with large international industrial and contracting companies active in the GCC and with banks and export credit agencies involved in the financing of trade or investment in the region. While the London branch has continued to focus on trade financing opportunities in North Africa, the Near East division in Bahrain and the Beirut representative office manage a similar range of business with the Near East. Attractive returns in these geographically close markets, risk-mitigating transaction structures, sound repayment records and the possibility of developing project finance opportunities offer a strategic rationale for this business. In addition, GIB's Treasury profile and location have proved attractive to central and commercial banks in these countries and a sizeable and consistent deposit taking activity has been built up.

Investment Banking

GIB's corporate advisory business in the GCC passed a significant milestone in 2002 when, acting as financial adviser to Saudi Arabia's Public Investment Fund, GIB successfully executed the Initial Public Offering (IPO) of 30% of the shares of the Saudi Telecom Company. This was a landmark in the Kingdom's recent economic development, being the first major IPO since the 1984 state sale to the public of shares in Saudi Arabia Basic Industries Corporation (SABIC).

GIB's involvement, as exclusive financial adviser, gave the corporate advisory team a broad and leading role in assisting the client in taking the key decisions and the many practical steps needed to launch and execute the flotation. Aside from their own direct advice and work on issues such as due diligence, valuation, sales strategy and prospectus, GIB was also instrumental in setting terms of reference for many of the other parties involved in the transaction including: legal advisers, public relations consultants, reporting accountants, the flotation processing manager and the receiving banks. Because of the time that had elapsed since the last Saudi IPO and following the introduction of a paper-less system for trading and registration of shares on the Saudi stock market, several procedures had to be designed, tested and implemented.

There is significant scope for further GIB involvement both directly in the wide-ranging privatisation programme recently announced by the Saudi Supreme Economic Council as well as in the changes in the capital markets infrastructure that will necessarily accompany the proposed deepening and broadening of equity ownership in Saudi Arabia. Elsewhere in the GCC, governments have also announced privatisation programmes and GIB is following these developments with keen interest.

In 2002, aside from the Saudi Telecom mandate, GIB was able to announce a follow-up IPO assignment with a private client, which it had helped to convert to joint stock company status in October 2000 through a private placement mandate. This company now intends to list its shares on the Saudi stock market in 2003. GIB's relationship managers throughout the Gulf are now trained to identify and refer those clients that could benefit from advice in corporate restructurings, mergers and acquisitions, placements of equity and debt, both corporate and project related.

Following GIB's appointment in 2001 as financial adviser on a US$1.5 billion debt placement for the 100% SABIC subsidiary, Jubail United Petrochemical Company, in 2002, GIB and Royal Bank of Scotland were appointed joint financial advisers for the independent water and power plant (IWPP) project to be contracted as part of the Saudi Gas Initiative Core Venture 3 in the Western Province.

Asset Management

Although 2002 represented a further year of deteriorating market conditions for asset management, particularly international equities and high yield corporate debt, GIB achieved some notable successes in this client-oriented business. During the year, clients committed a further US$1.5 billion to management by GIB's specialist teams. This sizeable increase in funds represents early success for the new 'One Bank' marketing strategy and the decision to establish an asset management marketing presence in Bahrain. In Europe, GIB launched one of the first Euro-denominated collateralised debt obligation (CDO) issues, raising 310 million from 23 investing institutions.

GIB Asset Management is recognised as perhaps the only remaining unit of a locally owned bank with an in-house global asset management capability. The marketing advantages associated with such a status should ensure further gains for GIB in the asset management business once market conditions become less volatile. The key will be the maintenance of GIB's sound reputation aligned with good absolute and relative investment performance.

GIB is planning for significant growth also in its other key asset management service, which is the more recent provision of a range of fund products. July 2002 saw the successful launch of the Falcon Capital Protected Relative Value Fund, which attracted over US$30 million in its first share series. Placement of the fund benefited considerably from active cross-selling by Gulf-based relationship managers and Treasury sales staff. Capital protection strategies are also acknowledged as a useful element in introducing first-time or less experienced investors into the hedge fund market.

The launch of the Falcon Capital Protected Relative Value Fund brought the number of funds in the GIB Asset Management stable up to 10. Other Falcon funds provide a range of both conventional and alternative investment products. The fund product and the higher-profile Gulf-wide marketing activity have enabled GIB Asset Management to expand its client base. Traditionally focused mainly on Saudi Arabia and institutional or government organisations, the client base is becoming more evenly distributed throughout the GCC. Moreover, with a minimum investment level ranging between US$100,000-US$500,000, the Falcon funds are attracting interest from smaller banks, financial institutions and corporations, as well as high net worth clients.

In related moves to increase the visibility of its fund range in the Gulf and to provide further assurance over their regulation and legal structure, GIB listed the entire family of Falcon funds on the Bahrain Stock Exchange in early 2002. For some of the more mature funds, already regulated by the Irish Financial Services Authority, this move represented dual listing.

Treasury

GIB's Treasury business group is responsible for the funding activities of the GIB Group and the capital market investment activities of the parent bank. As GIB's new strategy progressively reduces the relative weighting of commercial loans in the balance sheet, so the role of the Treasury function is changing. In the short term, the Treasury is operating as an increasingly self-contained unit, generating substantial and secure flows of net interest income through its investment of a sizeable deposit base in an expanding portfolio of investment grade Floating Rate Notes (FRNs). Over the longer term, GIB's Treasury is expected to fund more of the equity and underwriting positions generated by merchant banking activities. The client focus is on the provision of foreign exchange and interest rate hedging strategies. GIB's current Treasury operations can, moreover, be seen to have an importance beyond the institutional objectives of revenue generation and liquidity management. GIB's success in attracting an incremental volume of smaller bank, customer and Islamic deposits from the Gulf and neighbouring countries contributes to a more stable and productive mobilisation of resources through the banking systems of the region.

During 2002, GIB's Treasury made a strategic decision to lengthen the maturity of its funding, based on liquidity considerations rather than on yield curve opportunities. In pursuit of this objective, GIB raised five-year money through its own FRN issue. A very good market reception for this form of borrowing enabled the lead managers to close the deal at US$325 million and therefore above the top point of the initial target range. GIB's total senior term financing at the end of 2002 stood as a result at historically high levels representing coverage of almost a third of the loan book. These levels of medium-term financing are particularly important in light of GIB's increased emphasis on longer-term project and structured finance in the GCC.

GIB's liquidity cushion is further assured by deposit retention records that continue to demonstrate a more stable funding situation than that based on contractually measured maturities. In coordination with the GCC relationship management team, GIB Treasury has managed to develop further customer deposit and other client business to attain a broadly balanced profile vis-vis interbank activity.

Risk Management

Issues relating to GIB Groupwide credit and market risk measurement and management continued to receive highly focused and priority attention in 2002. Internally, a Group Risk Management Committee was set up and a software system selected to enable uniform Groupwide credit management policies and procedures to be implemented. With regard to market risk, the Value-at-Risk (VaR) measurement methodology was also standardised across the Group and subjected to rigorous stress testing. Considerable efforts have been extended to introduce the risk-adjusted return on capital (RAROC) methodology and the associated credit pricing tool as key management guides.

GIB accepts that it is increasingly the risk profile and management of its business as much as its financial performance that are scrutinised by regulators and credit rating agencies. In this context what has become vitally important for both management and external parties is accurate and transparent risk assessment, avoidance of risk concentrations and the close harnessing of sophisticated risk plotting and pricing tools to the planning process. Continued refinement to the systems for the measurement and the appropriate pricing of risk is a key business objective.

During 2002, the major credit rating agencies re-affirmed their previous ratings for GIB, as tabulated below:

	Fitch	Moody's	Standard & Poor's
Long-term	BBB+	Baa2	BBB+
Short-term	F-2	P-3	A-2
Individual	C		
Financial Strength		C-	
Outlook	Stable	Stable	Stable

Other Support Functions

A prime focus of GIB's support unit development during 2002 was the gradual rollout of the new 'One Bank' strategy into all areas of operation and administration. This involved not only continued aligning of GIB and GIBUK processes and procedures where possible, but also emphasis on developing fully functioning operations in the Riyadh branch. In addition, rationalisation of the New York branch saw its back office and control functions transferred to Bahrain and its money market operations to London. GIB also continued to respond along with the rest of the international banking community to changes in the global security situation, updating its compliance monitoring in line with new money laundering requirements and reinforcing existing business continuity strategies. In preparation for the introduction of the Basel II Capital Accord, moves were also initiated to establish an independent operational risk function to cover the entire Group.

Apart from GIB's continued attention to enhanced career development and training, the human resources function has needed to respond to several specific challenges introduced by the merger, the new merchant banking and relationship management strategy and the RAROC methodology. In-house presentations and training sessions have been organised to increase understanding of the new approaches and to assist relationship managers in marketing products and services with which they were not previously familiar. Compensation packages are being reviewed to reflect new responsibilities and changed perceptions of employee productivity introduced through the RAROC methodology. The key factor in this exercise has been to ensure maximum incentivisation within a highly cost conscious environment.

The integration of computer and communications systems between GIB business locations has permitted further refinement of business continuity procedures and processes that involve additional off-site locations. GIB has arrangements in place not only for data recovery, but also for full document and record retrieval and many of the practical and legal aspects involved in transfer and succession of personnel. These arrangements form part of GIB's comprehensive and thorough approach to operational risk.

"When you're dealing with a family business,
it's important to know you're also
dealing with a family"

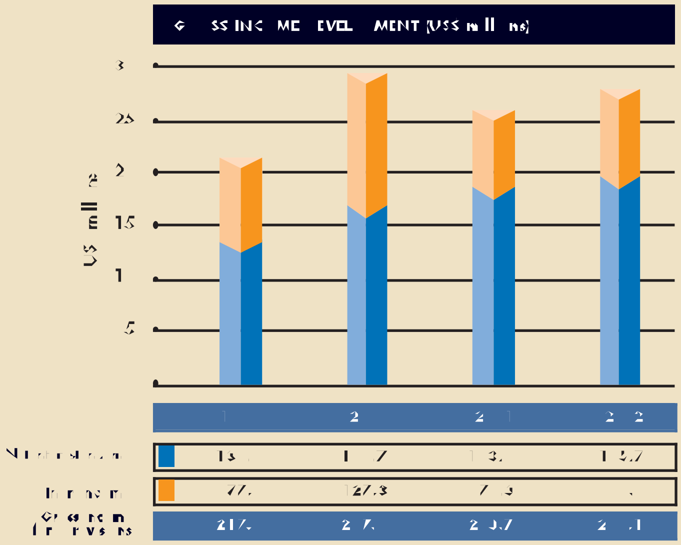
FINANCIAL REVIEW

CONSOLIDATED NET INCOME AFTER TAX was $85.3 million for the year, representing a return on average shareholders' equity of 7.3 per cent. While net income was lower than in the previous year, the financial performance in 2002 was particularly satisfactory given the adverse conditions prevailing in the international financial and credit markets. It also demonstrated the successful progress achieved in the implementation of the new GCC merchant banking strategy. 2002 net income was net of an $82.7 million provision charge for credit losses (2001: $52.1 million). Higher provisions for securities were required as default rates in international bond markets rose to historically high levels. However, at the pre-provision level, interest and non-interest income were both up on the previous year. Net interest income was slightly ahead of the prior year with the benefit of increased volumes offsetting the negative effect of lower market rates of interest. Higher investment banking and management fees contributed to a 25.7 per cent advance in non-interest earnings. Trading revenues were also positive in a continued difficult and challenging market environment. Operating expenses recorded a further decline, following a reduction in 2001, reflecting ongoing integration-related benefits and continued cost containment.

NET INTEREST INCOME

Net interest income at $195.7 million was $2.3 million up on the prior year. Net interest income is principally derived from four sources: earnings on the Group's net free capital, the commercial lending portfolio, the available-for-sale securities portfolio, and the money book. Money book interest earnings represent income derived from the mismatch of the repricing profile of the Group's interest-bearing assets and liabilities. Net interest income is also reported net of the funding cost of externally managed funds from which income is derived in the form of dividends and capital gains, and reported in the relevant category in other income.

Interest rates continued to decline in most developed economies in 2002. The lower interest rate environment impacted the Group's net interest earnings in three specific respects. The Group's net free capital is partly invested in fixed rate instruments in order to lock-in a fixed return over the medium term. Interest earnings on the net free capital were lower in 2002 as a result of the maturity and sale of a number of investments which were replaced at lower yields. In addition, while the Group's money book activity generated strong interest earnings, they were nevertheless 17 per cent lower than in 2001. Short interest rate mismatch positions were maintained throughout the year. The money book accordingly derived a significant benefit from the reductions in interest rates that took place during the year. However, interest rates declined by a far lesser extent in 2002



than in 2001. These negative factors were, however, partly compensated by a lower funding cost in respect of the externally managed funds resulting from the lower interest rate environment.

The overall negative impact of the lower interest rate environment on interest earnings was, however, more than offset by a year-on-year increase in net interest earnings from the available-for-sale securities portfolio. This reflected a $671.0 million or 9.5 per cent increase in the volume of debt securities during the year and also the benefit derived from a further widening in credit spreads in 2002. This provided attractive investment opportunities, even at the higher end of the credit rating spectrum. The credit quality of the securities portfolio continued to be emphasised with 91.4 per cent of available-for-sale debt securities at the 2002 year end being investment grade-rated.

Net interest earnings derived from the Group's commercial banking portfolio were also marginally higher in 2002. In line with the Group's strategic focus on the GCC, there was a further decrease in the volume of international loans during 2002. This was, however, more than offset by an increase in interest earnings from the Group's core GCC commercial banking portfolio resulting from an increase in average volumes with margins being maintained at much the same level as in 2001.

OTHER INCOME

Other income at $88.4 million for the year was $18.1 million or 25.7 per cent up on the prior year level. An analysis of other income with prior year comparatives is set out in note 18 to the consolidated financial statements.

The Group's various trading activities recorded a $1.4 million profit for the year compared to a $2.0 million loss in 2001. Profits were generated from trading activities in the foreign exchange, fixed income, derivative and emerging debt markets while corporate debt and equity trading incurred small losses. This positive outcome in extremely unfavourable market conditions was achieved through the strict application of disciplined and prudent risk management techniques. The limited loss on equity trading reflected the benefit derived from a wide range of trading strategies, including relative value, arbitrage and non-directional strategies.

Dividend income of $31.5 million was the largest contributor to other income. Dividend income was principally received from investments in the equity tranches of structured finance transactions and from externally managed funds. The funding cost of these investments is reported in net interest income. The year-on-year decrease in dividend income reflected the impact of the lower interest rate environment on the income from the underlying investments within the structured finance vehicles. The underlying investments are principally high quality, investment grade-rated debt securities.

Profits on available-for-sale securities were $19.4 million for the year. This largely comprised profits arising as a result of the active management of the investment of the Group's net free capital in fixed rate securities. The profits arose on the restructuring of the securities portfolio in order to increase the duration of the investments. An $8.3 million profit was also realised on the termination of derivative cash flow hedging transactions. The terminated interest rate swaps were replaced with longer tenor swaps in order to increase the duration of the portfolio.

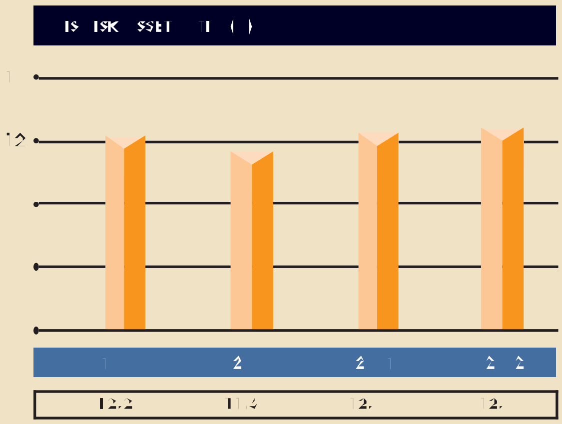
Investment banking and management fees at $17.0 million were a major, and increasing, contributor to non-interest earnings. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory and underwriting activities. These fees were $5.3 million or 45.3 per cent up on the prior year with year-on-year increases recorded by all activities although most notably in corporate finance and advisory fees. This reflected the successful development of the Group's corporate finance function as commented on in more detail in the Management Review section. Fund management fees were also 20 per cent up on the prior year reflecting an expanded range of fund products.

Commissions on letters of credit and guarantees at $7.6 million were 5.6 per cent up on the prior year and continued to make an important contribution to non-interest income. Other fee and sundry income principally comprised loan commitment and Islamic finance arrangement fees.

OPERATING EXPENSES

Operating expenses at $115.6 million were $2.5 million or 2.1 per cent down on the prior year. Prior year expenses included restructuring costs of $8.4 million associated with strategic reorganisation initiatives. During 2002, the Group continued to take measures to achieve further cost efficiencies through integration and the containment of recurring costs.

Staff expenses were $5.9 million or 8.9 per cent up on the prior year. This was attributable to



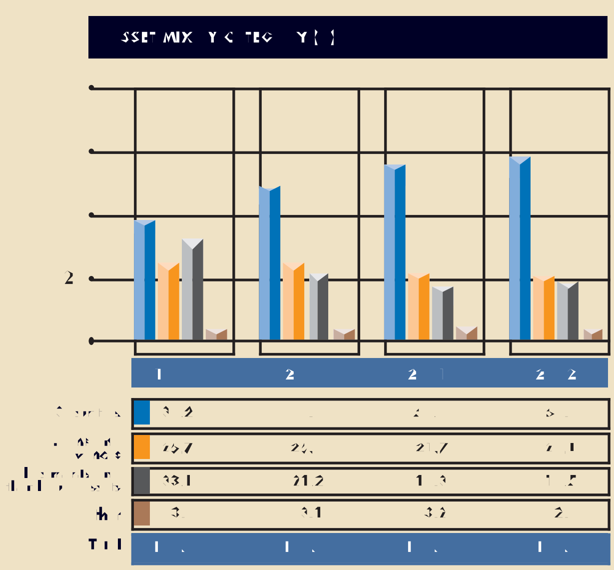
a higher pension expense and higher performance-related remuneration as a result of an improved trading performance and a significant increase in investment banking revenues. Premises and other operating expenses were both successfully contained at the previous years' levels as a result of ongoing cost control measures.

CAPITAL STRENGTH

Shareholders' equity amounted to $1,128.2 million at 31st December 2002. At the 2002 year end shareholders' equity and Tier 1 capital both represented 6.9 per cent of total assets, ratios that are high by international comparison. The average Tier 1 capital to total assets ratio of the top 1,000 banks was 4.8 per cent according to a survey published in The Banker in July 2002.

A $65.5 million decrease in shareholders' equity during 2002 comprised the net of the $85.3 million profit for the year, a $50 million dividend paid in respect of 2001, and a $100.8 million net decrease in the fair value of available-for-sale securities and derivative cash flow hedges. In accordance with IAS 39, changes in the fair values of available-for-sale securities and derivative cash flow hedges are accounted for in shareholders' equity.

With a total regulatory capital base of $1,573.8 million and total risk-weighted exposure of $12,306.2 million, the risk asset ratio calculated in accordance with the guidelines of the Basel Committee on Banking Supervision was 12.8 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 2002 year end net fair value losses of $141.8 million were added back to shareholder's equity to derive the regulatory capital base for capital adequacy purposes. The Bank's regulatory capital base was enhanced by two 10 year subordinated loan facilities amounting in total to $150.0 million. The subordinated loans have been approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency (BMA). The risk asset ratio incorporates market risk-weighted exposure. Exposure to general market risk is calculated utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risk. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the BMA. The high proportion of shareholders' equity within the total capital base resulted in a Tier 1 ratio of 10.3 per cent. Note 28 to the consolidated financial statements provides further details on capital adequacy. The risk asset ratio calculated in accordance with the guidelines of the Bank's regulatory authority, the BMA, was 14.5 per cent at the 2002 year end (2001: 14.1 per cent). Under the BMA guidelines, GCC governments and government-owned entities are accorded the same preferential risk weighting as for OECD governments. The BMA applies a minimum risk asset ratio of 12 per cent compared to a minimum of 8 per cent prescribed by the Basel Committee.



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

ASSET QUALITY

An assessment of the geographical diversification of risk assets may be made by reference to note 23 to the consolidated financial statements. Further assessment of asset quality can be facilitated by reference to note 30 to the consolidated financial statements on the fair value of financial instruments. Based on the valuation methodologies set out in that note, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values at 31st December 2002 by $16.4 million. Following the implementation of IAS 39 at the beginning of 2001, 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 2002 year end, available-for-sale securities accounted for 51.0 per cent of total assets while loans and advances represented 20.1 per cent.

Available-for-Sale Securities

Available-for-sale (AFS) securities totalled $8,280.4 million at 31st December 2002. The available-for-sale securities portfolio represents

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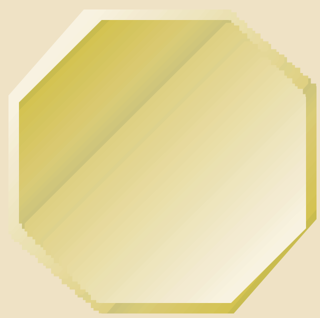

	US$ millions	
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[illegible]	[illegible]	[illegible]
Total	[illegible]	[illegible]

not only a substantial and effective liquidity reserve, but also an effective geographical diversification of the Group's risk assets with 78.4 per cent of the portfolio comprising securities of North American and European issuers.

AFS securities principally comprise two types of debt security portfolios and a more 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 82.1 per cent of the total AFS securities portfolio at the 2002 year end. The smaller debt security portfolio is made up of fixed income securities, principally OECD and GCC government or government-guaranteed bonds, representing the investment of part of the Group's net free capital. This portfolio amounted to $397.0 million at the end of 2002.

An analysis of the AFS securities portfolio by rating category is contained in note 6 (a) to the consolidated financial statements. $1,282.5 million or 15.5 per cent of the portfolio at the 2002 year end represented AAA/Aaa rated securities. Based on the rating of the issuer, a further $5,804.0 million or 70.1 per cent of the portfolio represented other investment grade-rated debt securities. Thus 85.6 per cent of the total portfolio comprised investment grade-rated securities. Other debt securities amounted to $664.8 million at the end of 2002, thus comprising only 8.0 per cent of the total AFS securities portfolio. Other debt securities comprise securities the issuers of which are rated below BBB-/Baa3 or are unrated. In view of the rising and historically high corporate default rates witnessed in the past two years, the Group has actively reduced the volume of securities rated below investment grade. As a result, other debt securities decreased by $223.4 million or 25.2 per cent during the year. The credit risk associated with these securities is rigorously monitored within the overall credit risk management process. The securities are therefore subject to the same stringent credit requirements as standard lending and credit-related contingent transactions. Equities and equity funds at 31st December 2002 amounted to

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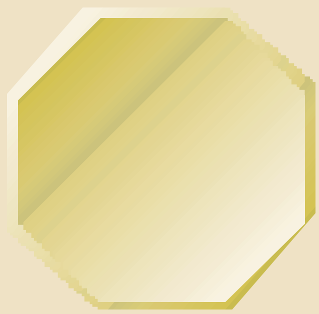

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$529.1 million. The equity and equity fund portfolio is principally invested in the equity tranches of structured finance transactions and, to a very limited extent, in a range of externally managed fund-type investments which provide a diversified exposure to private equity, debt and real estate markets.

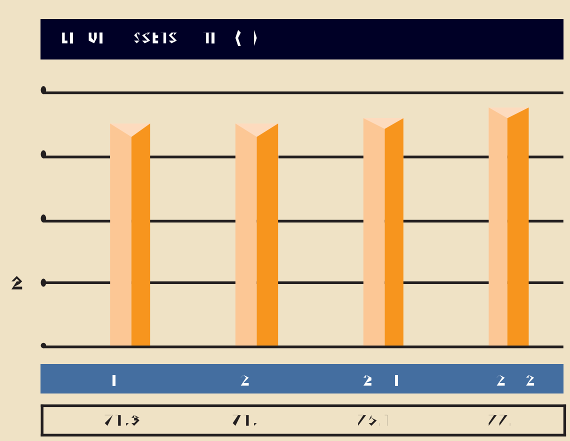
Loans and Advances

Loans and advances amounted to $3,255.8 million at the 2002 year end. This represented a small decrease compared to the 2001 year end. The decrease was attributable to the ongoing curtailment of the Group's international lending activity in line with the new strategic emphasis on relationship banking in the GCC. The geographical diversification of the Group's overall credit risk is achieved through the international securities markets rather than through participation in international syndicated lending transactions. Based on contractual maturities at the balance sheet date, 40.4 per cent of the loan portfolio was due to mature within one year while 66.9 per cent was due to mature within three years. Details of exposure within the loan portfolio to GCC and OECD country governments are contained in note 7 to the consolidated financial statements while the geographic distribution of loans and advances is set out in note 23. 76.4 per cent (2001: 68.4 per cent), or over three quarters, of the loan portfolio represented lending within GIB's core market in the GCC states while the balance was largely made up of exposure to the GCC countries' major trading partners in Europe and North America. The portfolio contained no significant concentrations by industrial sector. As discussed in note 30, the net fair value of loans and advances exceeded their net book value by $16.4 million.

Total loan loss provisions at 31st December 2002 amounted to $751.2 million. Country and counterparty specific provisions amounted to $560.8 million while non-specific provisions were $190.4 million. Specific provision utilisations during 2002 totalled $8.3 million. The utilisations arose on the sale of the related loans. While the loans were sold at less than nominal value, the proceeds exceeded the provisioned net book values thus giving rise to a release of specific provisions. The net release of specific loan provisions amounted to $0.5 million. Specific provisions are maintained in the currencies of the related exposures. The weakening in the US Dollar during the year against the Euro and Japanese Yen resulted in an $18.0 million increase in the US$ equivalent of specific loan provisions maintained in foreign currencies. This increase was, however, offset by an equivalent increase in the related loan exposures. The non-specific provision at the year end represented 5.7 per cent of loans which had not been specifically provided against.

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 based on the applicable credit ratings and associated historical default probabilities, loss severity and rating migrations, and reflect the current macroeconomic, political and business environment and other pertinent indicators. Loans are written off only after all reasonable restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote.

The gross and net book values of past due loans amounted to $570.1 million and $48.0 million respectively. The provisioning coverage for past due loans was therefore 91.6 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, which was implemented at the beginning of 2001, interest on impaired loans should be recognised in income based on 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 Bank's regulator, the BMA, interest on past due loans is only to be recognised in income on a cash basis. In view of the Group's high provisioning coverage for impaired loans, the difference between the two bases of accounting is not material. An ageing analysis of past due loans is set out in note 7(c) to the consolidated financial statements. $461.9 million, or 81.0 per cent, of gross past due loans were overdue by more than five years and are therefore historical in nature. These



are all fully provided against. Only $28.9 million of past due loans at 31st December 2002 had become past due during the preceding twelve months. This represented less than 1 per cent of gross loans. The gross volume of past due loans also continued to be substantially below total provisions. Total provisions for loan losses exceeded the gross volume of past due loans by $181.1 million. This means that rather than earnings being impaired by the funding cost of the net book value of past due loans, there is a positive earnings enhancement. Past due loans at their net book value of $48.0 million represented just 1.5 per cent of net loans. Past due loans at their net book value also represented only 4.3 per cent of shareholders' equity.

Other Asset Categories

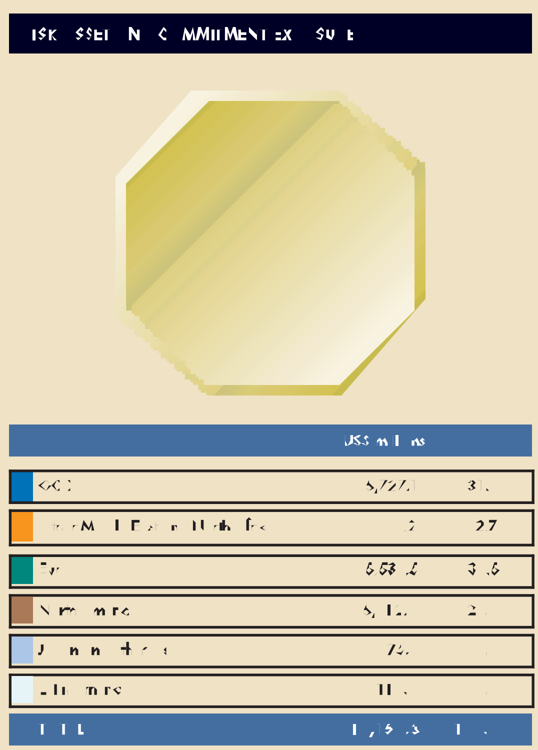
Cash and other liquid assets, which amounted to $147.6 million at the 2002 year end, are analysed in note 3 to the consolidated financial statements. In addition to cash and balances with banks, other liquid assets included certificates of deposit held for balance sheet management purposes.

Placements with banks totalled $3,024.0 million at the 2002 year end and were well diversified by geography as illustrated in note 23 to the consolidated financial statements. Placements with banks increased by $330.4 million during the year to represent 18.6 per cent of total assets at the year end. The significant volume of placements reflected a focus during the latter part of the year on enhancing liquidity in view of the uncertain environment. The Liquid Assets Ratio at the 2002 year end was a very strong 77.9 per cent.

Trading securities at $1,201.4 million largely comprised listed debt securities amounting to $974.1 million. Trading securities also included $137.7 million of managed funds. The funds, which are managed by international institutions with acknowledged expertise in their field, provide diversified exposure to foreign exchange and international debt markets.

Risk Asset and Commitment Exposure

Risk asset and commitment exposure at 31st



December 2002 amounted to $18,150.3 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of fixed and other assets) and credit-related contingent items. As alluded to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 23 to the consolidated financial statements. An analysis of derivatives and foreign exchange products is set out in note 26(a) while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 26(b).

FUNDING

Bank and customer deposits at 31st December 2002 totalled $10,846.5 million. A marginal decrease in total deposits compared to the 2001 year end reflected a temporary decrease over the year end due to the increasingly common practice, particularly by bank counterparties, to minimise exposures over financial reporting dates. A more useful illustration of the Group's funding position during the year is provided in the average consolidated balance sheet set out in note 33 to the consolidated financial statements. Total deposits averaged $11,474.3 million during 2002 being $627.8 million higher than at the year end. Customer deposits at the 2002 year end represented 47.1 per cent of total deposits compared to 43.5 per cent at the end of 2001. During the second half of the year, deposit tenors were extended in order to enhance the Group's funding profile in view of the uncertain environment. As a result, $1,930.0 million of deposits at the year end matured beyond three months. As illustrated in note 11 to the consolidated financial statements, 64.7 per cent, or almost two thirds, of total deposits were from the GCC. The Bank is a net placer of funds in the international interbank market. Securities sold under agreements to repurchase (Repos) increased to $2,576.7 million at 31st December 2002. The substantial increase in the volume of AFS securities facilitated the Group's ability to fund through this mechanism. Repos represent a more stable and cost effective source of funding, thereby enhancing both liquidity management and profitability. Term financing at 31st December 2002 totalled $1,005.0 million. During the first half of the year, the Bank successfully issued a new $325 million 5 year floating rate note replacing a $200 million floating rate note that matured in July and $100 million of maturing term loan facilities. Further commentary on liquidity and funding is provided in the Risk Management section of the Financial Review.

RISK MANAGEMENT

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

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

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

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to senior management. These functions include Risk Management, Credit Risk Control, Market Risk Control, Financial Controls and Internal Audit. This multi-faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives. Risks associated with off-balance sheet derivative instruments are managed within the overall risk management framework.

The major risks associated with the Group's business are credit, market, liquidity and operational risks. These risks and the related risk management processes are commented on in Note 22 to the Consolidated Financial Statements and are discussed in detail in the following sections.

Credit Risk

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

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

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit policies and procedures. Prior to the approval of a credit proposal, a detailed credit risk assessment is carried out which includes an analysis of the obligor's financial condition, market position, business environment and quality of management. The risk assessment generates an internal credit risk rating for each exposure, which affects the credit approval decision and the terms and conditions of the transaction. For cross border transactions, an analysis of country risk is also conducted. The Group bases its credit decision for each counterparty on the aggregate Group exposure to that counterparty and all its related entities.

Overall exposures are evaluated to ensure broad diversification of credit risk. Potential concentration risks by product, industry, single obligor, credit risk rating and geography are regularly assessed with a view to improving overall portfolio diversification. Established limits and actual levels of exposure are regularly reviewed by the Chief Credit Officers and other members of senior management. In general, all credit decisions 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 such as not having been authorized, appropriate or enforceable for a counterparty and documentation not being properly executed. The Group seeks to minimize these risks by the use of standard contract agreements and by obtaining the opinion of legal counsel regarding enforceability of agreements and the authority of a counterparty to transact.

The current gross positive market values or credit risk amounts of foreign exchange and derivative transactions are set out in Note 26 to the Consolidated Financial Statements. The total credit risk amount in respect of all such transactions outstanding at the 2002 year end amounted to $59.7 million before taking account of the risk-reducing benefits of any collateral held or legally enforceable netting agreements. The note highlights that 75.0 per cent of the total credit risk was concentrated on major OECD-based banks and was predominantly short-term in nature with 85.7 per cent of notional amounts of the transactions outstanding at the end of 2002 contracted to mature within one year. Transactions maturing beyond one year represented either hedging transactions entered into for asset and liability management purposes or fully offset customer transactions.

Market Risk

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

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

and convertibles.

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 variance/co-variance basis using exponentially weighted one-year historical daily movements in market rates and prices, giving greater importance to the more recent observations in estimating potential future losses. The VaR takes

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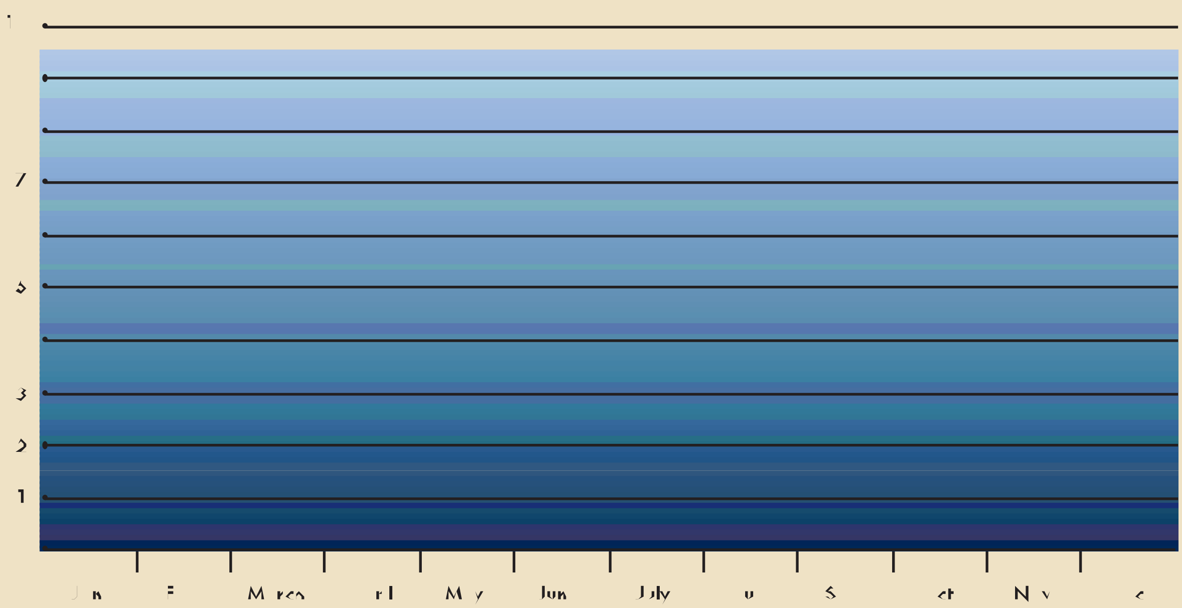

account of potential diversification benefits of different positions both within and across different portfolios. Consistent with general market practice, VaR is computed for all financial instruments for which there are readily available daily prices or a suitable proxy.

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

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

The graph on page 30 sets out the total Value-at-Risk for all the Group's trading activities at the close of each business day throughout the year. The figures are calculated using the regulatory

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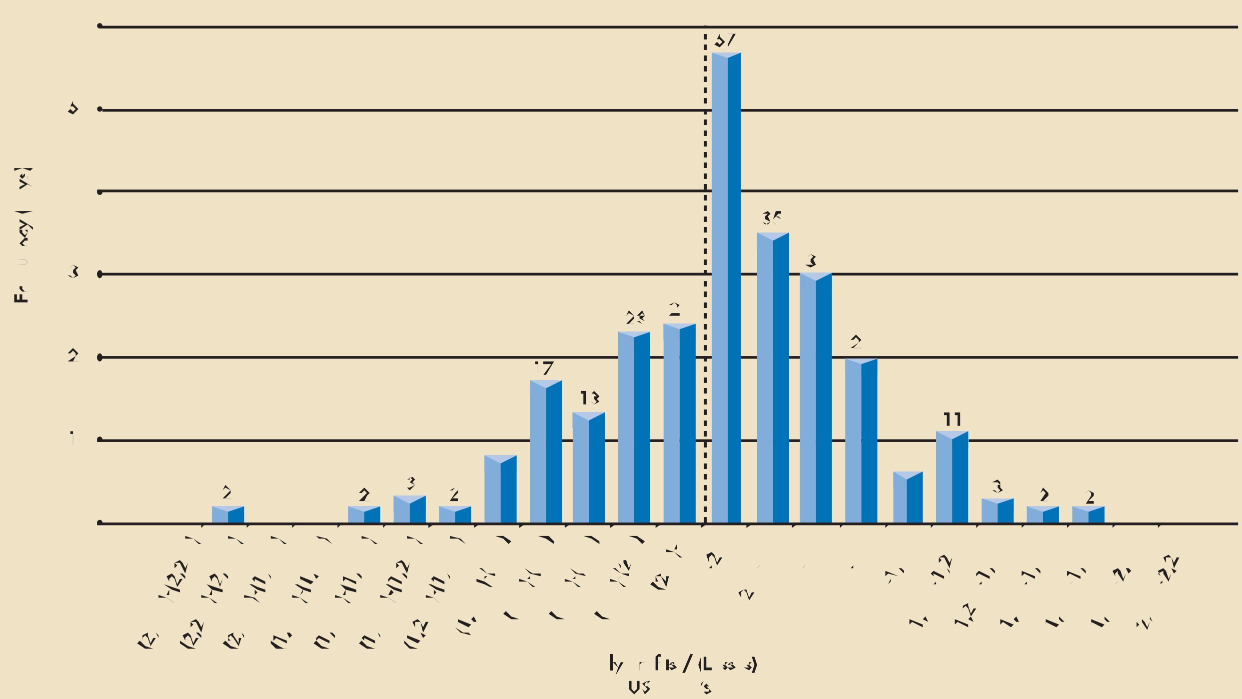
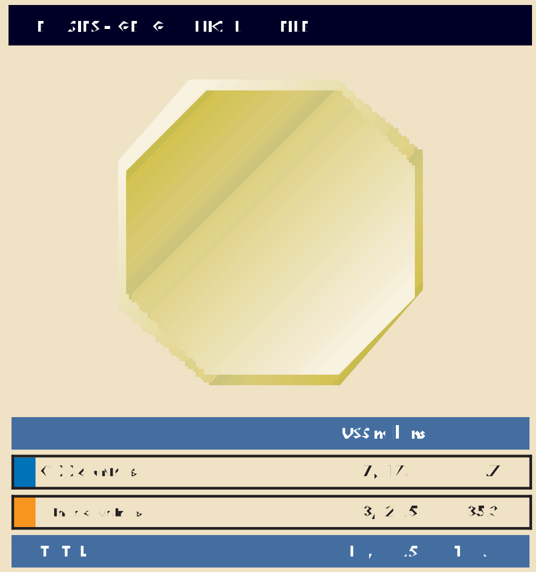


VaR basis at a 1 per cent risk level (2.33 standard deviations) and at the ten-day horizon using one-year unweighted historical daily movements in market rates and prices. On this basis, total diversified VaR over the year averaged $5.3 million and varied within the range of $2.8 million to $9.6 million with a 2002 year-end value of $3.3 million.

The Group conducts daily VaR back testing both for regulatory compliance with the Basel Committee on Banking Supervision market risk capital rules and for internal evaluation of VaR against trading profit and losses. During 2002, there were no occasions on which a daily trading loss exceeded the trading VaR at the close of business on the previous business day. The Basel Committee's guidelines on back testing permit a maximum of five excesses beyond which the multiplication factor determined by the regulator may be increased.

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (e.g. beyond the 99% 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 that result from pre-specified market scenarios, including both historical and hypothetical market events. Historical scenarios include the 1994 bond market sell-off, the 1995 Mexican Peso crisis, the 1998 Russian crisis and the 2001 September 11 market disruption. Stress testing is performed for all material trading and investment portfolios.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability repricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile and details of the effective interest rates prevailing at the year end on the various asset and liability categories are set out in Note 25 to the Consolidated Financial Statements. The repricing profiles of individual assets and liability categories incorporate the effect of interest rate swaps used to modify the interest rate characteristics of specific transactions. As illustrated in Note 25, the substantial majority of assets and liabilities reprice within one year. The volume of interest-bearing assets repricing over one year amounted to only $795.0 million or 4.9 per cent of Total Assets. This mainly represented the investment of the Group's net free capital through fixed rate securities, with a modified duration of 2.0 years at 31st December 2002.

Liquidity Risk and Funding

Liquidity risk is the risk of the Group's financial obligations not being met fully and punctually 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.

The Group maintains a strong liquidity position by managing the liquidity structure of assets, liabilities and commitments to ensure the Group has access to adequate funds to meet its obligations even under adverse market conditions. In normal market conditions, the Group endeavours to ensure that there are sufficient funds not only to meet current obligations but also to provide the flexibility to capitalise on market opportunities.

The Group applies a prudent mixture of liquidity controls that provide security of access to funds without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The liquidity controls ensure that over the short term, by major currency, the projected profile of future cash flows from maturing assets is adequately matched to the maturity of liabilities. Liquidity is managed and monitored on a daily basis at the parent company and subsidiary levels, enabling senior management to identify changes and to react accordingly to fluctuations in market conditions.

The Group maintains strong balance sheet liquidity ratios and regularly monitors its depositors to ensure it retains a diversified deposit base in terms of name concentration, range of counterparties and maturities. The Group maintains a stock of liquid and marketable securities that can be readily sold or repoed. The funding base is enhanced through term financing of $1,005 million. Deposits from customers provide a further stable source of funding. Contingency plans also exist that can be quickly implemented to maintain liquidity in crisis situations without hindering long-term business objectives.

The asset and liability maturity profile by individual asset and liability category based on contractual repayment arrangements is set out in Note 24 to the Consolidated Financial Statements. At 31st December 2002, 42.4 per cent of Total Assets were contracted to mature within one year. A significant portion of assets with longer-term maturities comprised readily realisable securities. 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 2002 from those counterparties with deposits over $10 million at 31st December 2002 amounted to $9,965.5 million. These deposits of a core nature together with Shareholders' Equity and Term Financing were three and a half times the least liquid asset category, Loans and Advances. The more stable deposits from the GCC region also comfortably exceed the loan portfolio. At 31st December 2002 deposits from GCC country governments and central banks and other institutions headquartered in the GCC states amounted to $7,017.0 million. GCC deposits to total loans cover was therefore 2.2 times. Total deposits and term financing coverage to loans was 3.6 times while the liquid assets ratio, which expresses the sum total of bank balances, money market instruments, placements with banks and securities as a percentage of total assets, was a very high 77.9 per cent.

Operational Risk

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

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

A risk assessment has been compiled which identifies the operational risks inherent in the Group's activities, processes and systems, and the controls required to mitigate these risks are constantly under review and updated as necessary. A database of measurable operational losses is maintained, together with a record of key risk indicators, which can provide an early warning of possible operational risk. The process of Management reporting is currently under review.

The Group ensures that its processes are in line with best practice and that it takes account of lessons learned from published failures within the global financial services industry. In addition, the Group has a strong Internal Audit function, which undertakes periodic, independent appraisals of the actual functioning of the controls in all the identified risk areas and reports on their findings to the Audit Committee of the Board of Directors.

"When you get to be part of a project
from the very beginning, you feel
a real sense of shared ownership"

FINANCIAL STATEMENTS

Contents

REPORT OF THE AUDITORS TO THE SHAREHOLDERS

We have audited the consolidated financial statements of Gulf International Bank B.S.C. (the Bank) and its subsidiaries (the Group) as at, and for the year ended, 31st December 2002 set out on pages 39 to 76.

Respective responsibilities of directors and auditors

These consolidated financial statements are the responsibility of the directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

Basis of opinion

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31st December 2002, the results of its operations, its cash flows and its changes in shareholders' equity for the year then ended, in accordance with International Accounting Standards as adopted by the International Accounting Standards Board. Additionally, in our opinion, the Bank has complied with the terms of its banking licence, the provisions of the Bahrain Monetary Agency Law 1973 (as amended) and the provisions of the Bahrain Commercial Companies Law 1975 (as amended).

Other regulatory matters

In addition, in our opinion, the Group has maintained proper accounting records and the consolidated financial statements are in agreement therewith. We have reviewed the accompanying Chairman's Statement and confirm that the information contained therein is consistent with the consolidated financial statements.

To the best of our knowledge and belief, no violations of the Agreement of Establishment and Articles of Association have occurred during the year that might have had a material adverse effect on the business of Gulf International Bank B.S.C. or on its financial position. Satisfactory explanations and information were provided to us by management in response to all our requests.

KPMG.

KPMG
Public Accountants
Manama, Bahrain
8th March, 2003

CONSOLIDATED BALANCE SHEET

	Note	**At 31.12.02 US$ millions**	At 31.12.01 US$ millions
ASSETS			
Cash and other liquid assets	3	**147.6**	91.2
Placements with banks	4	**3,024.0**	2,693.6
Trading securities	5	**1,201.4**	1,006.7
Available-for-sale securities	6	**8,280.4**	7,641.7
Loans and advances	7	**3,255.8**	3,309.4
Fixed assets	8	**20.6**	22.5
Other assets	9	**306.7**	466.9
Total assets		**16,236.5**	15,232.0
LIABILITIES			
Deposits from banks	11	**5,742.0**	6,191.0
Deposits from customers	11	**5,104.5**	4,758.7
Securities sold under agreements to repurchase		**2,576.7**	1,422.4
Securities sold but not yet purchased		**53.3**	122.6
Other liabilities	12	**626.8**	563.6
Senior term financing	13	**855.0**	830.0
Subordinated term loans	14	**150.0**	150.0
Total liabilities		**15,108.3**	14,038.3
SHAREHOLDERS' EQUITY			
Share capital	15	**1,000.0**	1,000.0
Share premium		**7.6**	7.6
Reserves	16	**37.1**	133.5
Retained earnings		**83.5**	52.6
Shareholders' equity		**1,128.2**	1,193.7
Total liabilities & shareholders' equity		**16,236.5**	15,232.0

The consolidated financial statements were approved by the Board of Directors on 8th March 2003 and signed on their behalf by:-

Ebrahim Bin Khalifa Al Khalifa
Chairman

Dr. Khaled M. Al-Fayez
Chief Executive Officer

The notes on pages 43 to 76 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME

	Note	**Year ended 31.12.02 US$ millions**	Year ended 31.12.01 US$ millions
INTEREST REVENUE			
Interest on securities		**343.5**	434.0
Interest and fees on loans		**117.1**	222.4
Interest on placements and other liquid assets		**67.0**	127.7
		527.6	784.1
INTEREST EXPENSE		**331.9**	590.7
Net interest income		**195.7**	193.4
Provisions for securities	6	**83.2**	69.9
Provisions for loans and advances	7	**(0.5)**	(17.8)
Net interest income after provisions		**113.0**	141.3
OTHER INCOME	18	**88.4**	70.3
Net interest and other income		**201.4**	211.6
OPERATING EXPENSES			
Staff		**72.4**	66.5
Premises		**9.6**	9.7
Restructuring costs	19	**-**	8.4
Other		**33.6**	33.5
		115.6	118.1
Net income before tax		**85.8**	93.5
Taxation charge / (credit) on overseas activities	20	**0.5**	(7.0)
Net income after tax		**85.3**	100.5
Earnings per share	*31*	***US$0.09***	*US$0.10*

The notes on pages 43 to 76 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS

	Year ended 31.12.02 US$ millions	Year ended 31.12.01 US$ millions
OPERATING ACTIVITIES		
Net income	**85.3**	100.5
Adjustments to reconcile net income to net cash outflow from operating activities:		
Provisions for securities	**83.2**	69.9
Provisions for loans and advances	**(0.5)**	(17.8)
Profit on available-for-sale securities	**(19.4)**	(9.4)
Amortisation of available-for-sale securities	**16.5**	8.3
Depreciation of fixed assets	**7.1**	9.7
Decrease in accrued interest receivable	**37.3**	73.3
Decrease in accrued interest payable	**(34.7)**	(58.1)
Decrease in other net assets	**5.3**	22.5
Net increase in trading securities	**(194.7)**	(540.9)
Net cash outflow from operating activities	**(14.6)**	(342.0)
INVESTING ACTIVITIES		
Net (increase) / decrease in placements with banks	**(330.4)**	371.4
Net decrease in loans and advances	**54.1**	631.5
Purchase of available-for-sale securities	**(3,337.5)**	(3,135.7)
Sale and maturity of available-for-sale securities	**2,733.2**	2,482.6
Purchase of fixed assets	**(5.2)**	(5.0)
Net cash (outflow) / inflow from investing activities	**(885.8)**	344.8
FINANCING ACTIVITIES		
Net decrease in deposits from banks	**(449.0)**	(323.5)
Net increase / (decrease) in deposits from customers	**345.8**	(141.3)
Net increase in securities sold under agreements to repurchase	**1,154.3**	257.8
Net (decrease) / increase in securities sold but not yet purchased	**(69.3)**	78.1
Increase / (decrease) in senior term financing	**25.0**	(20.0)
Increase in subordinated term loans	**-**	150.0
Dividends paid	**(50.0)**	(50.0)
Net cash inflow / (outflow) from financing activities	**956.8**	(48.9)
Increase / (decrease) in cash and cash equivalents	**56.4**	(46.1)
Cash and cash equivalents at 1st January	**91.2**	137.3
Cash and cash equivalents at 31st December	**147.6**	91.2

Movements in trading securities and available-for-sale securities are stated net of inter portfolio transfers.

The notes on pages 43 to 76 form part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

US$ millions	Share capital US$ millions	Share premium US$ millions	Reserves US$ millions	Retained earnings US$ millions	Total
At 1st January 2001 as previously reported	**1,000.0**	**7.6**	**100.3**	**97.9**	**1,205.8**
Effect of adopting IAS 39:-					
- Available-for-sale securities remeasured to fair value	-	-	-	(45.2)	(45.2)
- Derivative transactions not qualifying as hedges remeasured to fair value	-	-	-	(19.4)	(19.4)
- Derivatives qualifying as fair value hedges remeasured to fair value	-	-	-	(21.4)	(21.4)
- Hedged loans, placements and deposits remeasured to fair value	-	-	-	(3.4)	(3.4)
- Derivatives qualifying as cash flow hedges remeasured to fair value	-	-	0.7	-	0.7
Opening balances restated	**1,000.0**	**7.6**	**101.0**	**8.5**	**1,117.1**
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	6.2	-	6.2
- Cash flow hedges: net fair value gains	-	-	6.9	-	6.9
Transfers in the year:-					
- Transfer to net income on disposal / impairment	-	-	-	13.0	13.0
Net gains not recognised in net income	-	-	13.1	13.0	26.1
Dividend for 2000	-	-	-	(50.0)	(50.0)
Net income for the year	-	-	-	100.5	100.5
Transfers from retained earnings	-	-	19.4	(19.4)	-
At 31st December 2001	**1,000.0**	**7.6**	**133.5**	**52.6**	**1,193.7**
Arising in the year:-					
- Available-for-sale securities: net fair value losses	-	-	(113.1)	-	(113.1)
- Cash flow hedges: net fair value gains	-	-	13.7	-	13.7
Transfers in the year:-					
- Transfers to net income	-	-	(14.0)	12.6	(1.4)
Net (losses)/gains not recognised in net income	-	-	(113.4)	12.6	(100.8)
Dividend for 2001	-	-	-	(50.0)	(50.0)
Net income for the year	-	-	-	85.3	85.3
Transfers from retained earnings	-	-	17.0	(17.0)	-
At 31st December 2002	**1,000.0**	**7.6**	**37.1**	**83.5**	**1,128.2**

The notes on pages 43 to 76 form part of these consolidated financial statements.

1. INCORPORATION AND REGISTRATION

The parent company of the Group (the Group), Gulf International Bank B.S.C. (the Bank), is a Bahraini Shareholding Company incorporated in the Kingdom of Bahrain by Amiri Decree Law No. 30 dated 24th November 1975 and is registered as an offshore banking unit with the Bahrain Monetary Agency. The registered office of the Bank is located at Al-Dowali Building, 3 Palace Avenue, Manama, 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 608.

2. ACCOUNTING POLICIES

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

2.1 Basis of presentation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards promulgated by the International Accounting Standards Board. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, available-for-sale securities and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year with the exception of a change in the accounting policy for investments in subsidiaries as described in more detail in Note 34.

On 1st January 2001, the Group adopted International Accounting Standard (IAS) No. 39 – Financial Instruments: Recognition and Measurement. The adoption of IAS 39 resulted in changes in the accounting policies in respect of the recognition and measurement of derivative financial instruments, securities, loans and advances, and provisions for impairment. IAS 39 was applied prospectively in accordance with the requirements of the standard. The financial effects of adopting IAS 39 are reported in the consolidated statement of changes in shareholders' equity. The changes in the accounting policies of the Group resulting from the adoption of IAS 39 are described in more detail in the relevant accounting policies and the related notes 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. ACCOUNTING POLICIES (continued)

2.3 Trade and settlement date accounting

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

2.4 Foreign currencies

The reporting currency of the Group is the US Dollar. The share capitals of the Bank and its principal subsidiaries are also denominated in US Dollars. 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 on the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in other income.

2.5 Offsetting

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

2.6 Derivative financial instruments

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

On the adoption of IAS 39, the Group recognised for the first time the fair value of all derivative financial instruments in the consolidated balance sheet as either assets (positive fair values) or liabilities (negative fair values). Prior to the adoption of IAS 39, only the fair values of derivative financial instruments entered into for trading purposes were recognised in the consolidated balance sheet. Derivative financial instruments entered into for hedging purposes were accounted for at cost and related gains and losses deferred and recognised as income or expense on an amortisation basis over the life of the hedged asset or liability. Following the adoption of IAS 39, all derivative financial instruments are initially recognised in the consolidated balance sheet at cost, including transaction costs, and subsequently remeasured to fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate. In the consolidated balance sheet, derivative financial instruments with positive fair values (unrealised gains) are included in other assets and derivative financial instruments with negative fair values (unrealised losses) are included in other liabilities.

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

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

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

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

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

Changes in the fair values of derivative financial instruments that are designated, and qualify, as cash flow hedges and that prove to be highly effective in relation to the hedged risk, are recognised in a separate component of shareholders' equity. Unrealised gains or losses on any ineffective portion of cash flow hedging transactions are recognised in other income in the consolidated statement of income.

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

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

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

2.7 Interest income and expense

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

2. ACCOUNTING POLICIES (continued)

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 Securities

Prior to the adoption of IAS 39, debt and equity securities that were intended to be held for the long term were categorised as investment securities and stated at amortised cost less provision for impairment. On the adoption of IAS 39, all investment securities were reclassified as available-for-sale and remeasured to fair value. The unrealised gains and losses arising on the remeasurement of available-for-sale securities to fair value at 1st January 2001 were accounted for as an adjustment to the opening balance of retained earnings. Available-for-sale securities are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, changes in interest rates or concerns with respect to credit deterioration.

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

Available-for-sale securities are initially recognised at cost, including transaction costs, and subsequently remeasured to fair value based on quoted market prices or amounts derived from cash flow models as appropriate. Unquoted and illiquid equity investments for which fair values cannot be reliably measured are stated at cost less provision for impairment. Unrealised gains and losses arising from changes in the fair values of available-for-sale securities after the adoption of IAS 39 on 1st January 2001 are recognised in a separate revaluation reserve in shareholders' equity. The cumulative fair value adjustments on available-for-sale securities which are sold or otherwise disposed of, or become impaired, and which had previously been recognised in shareholder's equity, are transferred to the consolidated statement of income.

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

Bonds received in settlement of sovereign debt interest and principal claims are capitalised at the same net book value as other debt obligations of that country. The capitalised amount of bonds received in settlement of interest claims is included in interest income.

2.10 Loans and advances

Loans originated by the Group by providing money directly to the borrower or to a sub-participation agent at the drawdown date are categorised as loans originated by the Group. Originated loans are stated at amortised cost less provision for impairment.

All purchased loans, including sub-participations acquired subsequent to the provision of the original loan, are intended to be held to maturity and are accordingly categorised as held-to-maturity assets and stated at amortised cost less provision for impairment.

Prior to the adoption of IAS 39, all loans and advances were stated at amortised cost less provision for impairment.

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

2.11 Provisions for impairment

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

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

Provisions for impairment are released where a subsequent increase in the recoverable amount is related objectively to an event occurring after the provision for impairment was established.

The adoption of IAS 39 had no impact on the Group's overall level of provisions for impairment at 1st January 2001, and did not affect the Group's policies in respect of income recognition, write offs or recoveries.

2.12 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.

2.13 Fixed assets

Land is stated at cost. Other fixed assets are stated at cost less accumulated depreciation. Where the carrying amount of a fixed asset is greater than its estimated recoverable amount, the asset is written down to its recoverable amount.

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

2. ACCOUNTING POLICIES (continued)

2.14 Post retirement benefits

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

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

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

2.15 Deferred income taxes

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

2.16 Cash and cash equivalents

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

2.17 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.

2.18 Fiduciary activities

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

2.19 Comparatives

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

3. CASH AND OTHER LIQUID ASSETS

	31.12.02 US$ millions	31.12.01 US$ millions
Cash and balances with banks	**143.4**	42.5
Certificates of deposit	**3.0**	36.4
Treasury bills	**1.2**	1.2
Securities purchased under agreements to resell	**-**	11.1
	147.6	91.2

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

4. PLACEMENTS WITH BANKS

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

Placements with banks at 31st December 2002 included placements with non-bank financial institutions amounting to US$51.0 million (2001: US$173.7 million).

5. TRADING SECURITIES

	31.12.02 US$ millions	31.12.01 US$ millions
Government bonds	**65.1**	136.5
Listed debt securities	**974.1**	637.4
Unlisted debt securities	**14.4**	23.7
Managed funds	**137.7**	184.3
Equities	**10.1**	24.8
	1,201.4	1,006.7

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

6. AVAILABLE-FOR-SALE SECURITIES

Prior to the adoption of IAS 39 on 1st January 2001, all debt and equity securities that were intended to be held for the long term were categorised as investment securities and stated at amortised cost less provision for impairment. On the adoption of IAS 39, all investment securities were reclassified as available-for-sale and remeasured to fair value. The adjustment to fair value arising on the adoption of IAS 39 is reported in the consolidated statement of changes in shareholders' equity.

Available-for-sale securities at 31st December 2002 included US$81.0 million (2001: US$ 94.3 million) of unquoted and illiquid equity investments for which fair values cannot be reliably measured. These investments are stated at cost less provision for impairment. They principally comprise investments in special purpose vehicles, 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 recoverable amounts of the investments are considered to be not materially dissimilar to their carrying amounts.

6. AVAILABLE-FOR-SALE SECURITIES (continued)

a) Classification of available-for-sale securities

	31.12.02 US$ millions	31.12.01 US$ millions
AAA/Aaa rated debt securities	**1,282.5**	1,088.7
Debt securities of other investment grade issuers	**5,804.0**	5,103.4
Other debt securities	**664.8**	888.2
Equities and equity funds	**529.1**	561.4
	8,280.4	7,641.7

The Group's available-for-sale securities predominantly comprise higher quality, investment grade-rated debt securities. At 31st December 2002, 85.6% of available-for-sale securities were investment grade-rated (2001: 81.0%).

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

Debt securities of other investment grade issuers at 31st December 2002 included GCC country government securities of US$1,151.7 million (2001: US$1,017.2 million).

b) Provisions for impairment

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

	2002 US$ millions	2001 US$ millions
At 1st January	**80.4**	24.2
Exchange rate movements	**2.9**	-
Amounts utilised	**(40.9)**	(13.7)
Charge for the year	**83.2**	69.9
At 31st December	**125.6**	80.4

7. LOANS AND ADVANCES

	31.12.02 US$ millions	31.12.01 US$ millions
Loans originated by the Group	**3,832.0**	3,823.6
Loans purchased by the Group - held to maturity	**175.0**	227.8
Gross loans and advances	**4,007.0**	4,051.4
Provisions for impairment	**(751.2)**	(742.0)
Net loans and advances	**3,255.8**	3,309.4

a) Concentrations of loans and advances

Net loans and advances at 31st December 2002 included exposure to GCC country governments of US$323.2 million (2001: US$352.2 million) and OECD country central government and agency risk of US$124.4 million (2001: US$165.7 million).

There were no significant concentrations by industrial sector at 31st December 2002 or at 31st December 2001.

b) Provisions for impairment

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

	2002			2001		
	Specific provision US$ millions	**Non-specific provision US$ millions**	**Total US$ millions**	Specific provision US$ millions	Non-specific provision US$ millions	Total US$ millions
At 1st January	**551.6**	**190.4**	**742.0**	602.2	190.7	792.9
Exchange rate and other movements	**18.0**	**-**	**18.0**	(13.3)	(0.3)	(13.6)
Amounts utilised	**(8.3)**	**-**	**(8.3)**	(19.5)	-	(19.5)
Release for the year	**(0.5)**	**-**	**(0.5)**	(17.8)	-	(17.8)
At 31st December	**560.8**	**190.4**	**751.2**	551.6	190.4	742.0

Total specific provisions at 31st December 2002 represented 84.8% of loans against which a specific provision had been made (2001: 79.5%). Total non-specific provisions at 31st December 2002 represented 5.7% of loans which had not been specifically provided against (2001: 5.7%). Total provisions at 31st December 2002 exceeded the gross book value of past due loans by US$181.1 million (2001: US$192.1 million).

At 31st December 2002, there was no accrued but uncollected interest on impaired loans included in interest income (2001: nil).

c) Past due loans

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

	31.12.02		31.12.01	
	Gross US$ millions	**Net book value US$ millions**	Gross US$ millions	Net book value US$ millions
Sovereign	**421.8**	**0.7**	405.7	0.6
Corporate	**143.6**	**47.3**	135.0	52.2
Financial institutions	**4.7**	**-**	9.2	3.2
	570.1	**48.0**	549.9	56.0

7. LOANS AND ADVANCES (continued)

c) Past due loans (continued)

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

	31.12.02 US$ millions	31.12.01 US$ millions
Within 6 months	**2.5**	25.4
7 months to 1 year	**26.4**	-
2 to 5 years	**79.3**	73.8
Over 5 years	**461.9**	450.7
	570.1	549.9

At 31st December 2002 uncollected interest-in-suspense on past due loans amounted to US$501.3 million (2001: US$464.2 million).

8. FIXED ASSETS

	Freehold land US$ millions	**Buildings US$ millions**	**Premises and equipment US$ millions**	**Total US$ millions**
At 31st December 2002				
Cost	**8.9**	**27.3**	**56.9**	**93.1**
Accumulated depreciation	**-**	**26.4**	**46.1**	**72.5**
Net book value	**8.9**	**0.9**	**10.8**	**20.6**
At 31st December 2001				
Net book value	8.9	0.7	12.9	22.5

9. OTHER ASSETS

	31.12.02 US$ millions	31.12.01 US$ millions
Accrued interest, fees and commissions	**183.2**	216.2
Derivative financial instruments	**32.2**	114.9
Outstanding security settlements	**32.5**	68.9
Deferred items	**15.7**	14.7
Prepaid pension cost	**13.0**	17.5
Other prepayments	**4.8**	4.3
Other, including accounts receivable	**25.3**	30.4
	306.7	466.9

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 26 (a).

10. POST RETIREMENT BENEFITS

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

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31st December 2002 amounted to US$3.2 million (2001: US$3.4 million).

The Bank's principal subsidiary, Gulf International Bank (UK) Limited (GIBUK), maintains a defined benefit pension plan for substantially all its employees. The assets of the plan are held independently of the subsidiary's assets in a separate trustee administered fund. The pension costs are charged to income so as to spread the regular cost of the pensions over the service lives of the employees, in accordance with the advice of an independent qualified actuary who conducts a full valuation of the plan every three years using the projected unit credit method. In the intervening years, the calculation is updated based on information received from the actuary. The latest full actuarial valuation was carried out at 1st January 2001.

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

	31.12.02 US$ millions	31.12.01 US$ millions
Fair value of plan assets	**59.1**	64.6
Present value of fund obligations	**78.1**	69.7
	(19.0)	(5.1)
Unrecognised actuarial loss	**32.0**	22.6
Net asset in the consolidated balance sheet	**13.0**	17.5

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

	2002 US$ millions	2001 US$ millions
At 1st January	**17.5**	19.5
Net expense included in staff expenses	**(4.5)**	(1.5)
Exchange differences	**-**	(0.5)
At 31st December	**13.0**	17.5

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

	2002 US$ millions	2001 US$ millions
Current service cost	**4.6**	3.7
Interest cost	**3.6**	3.1
Expected return on plan assets	**(4.5)**	(5.3)
Amortisation of actuarial loss	**0.8**	-
Total included in staff expenses	**4.5**	1.5

10. POST RETIREMENT BENEFITS (continued)

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

	2002	2001
Discount rate	**5.0%**	5.0%
Expected return on plan assets	**7.0%**	7.0%
Future salary increases	**3.9%**	4.5%
Future increases to pensions in payment	**2.3%**	2.3%

11. DEPOSITS

Deposits from customers include deposits from central banks

The geographical composition of total deposits was as follows:-

	31.12.02 US$ millions	31.12.01 US$ millions
GCC countries	**7,017.0**	7,180.6
Other countries	**3,829.5**	3,769.1
	10,846.5	10,949.7

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

12. OTHER LIABILITIES

	31.12.02 US$ millions	31.12.01 US$ millions
Derivative financial instruments	**308.2**	224.2
Accrued interest	**151.3**	184.4
Outstanding security settlements	**9.4**	85.1
Deferred items	**63.8**	17.5
Minority interests	**30.6**	-
Other, including accounts payable and accrued expenses	**63.5**	52.4
	626.8	563.6

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 26 (a).

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.

13. SENIOR TERM FINANCING

	31.12.02 US$ millions	31.12.01 US$ millions
US$ Floating rate loan due in 2003	**50.0**	50.0
US$ Floating rate loan due in 2004	**50.0**	50.0
US$ Floating rate loan due in 2005	**400.0**	400.0
US$ Floating rate loan due in 2006	**30.0**	30.0
US$ Floating rate note due in 2007	**325.0**	-
US$ Floating rate note due in 2002	**-**	200.0
US$ Floating rate loan due in 2002	**-**	100.0
	855.0	830.0

14. SUBORDINATED TERM LOANS

	31.12.02 US$ millions	31.12.01 US$ millions
US$ Floating rate loan due in 2011	**100.0**	100.0
US$ Floating rate loan due in 2011	**50.0**	50.0
	150.0	150.0

The subordinated term loans 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 loans have been approved for inclusion in Tier 2 capital for capital adequacy purposes by the Bank's regulator, the Bahrain Monetary Agency.

15. SHARE CAPITAL

The authorised share capital at 31st December 2002 comprised 3.0 billion shares of US$1 each (2001: 3.0 billion shares of US$1 each). The issued share capital at 31st December 2002 comprised 1.0 billion shares of US$1 each (2001: 1.0 billion shares of US$1 each). All issued shares are fully paid.

16. RESERVES

	Compulsory reserve US$ millions	Voluntary reserve US$ millions	Cash flow hedge reserve US$ millions	Available-for-sale securities revaluation reserve US$ millions	Total US$ millions
At 1st January 2001 as previously reported	**81.4**	**18.9**	**-**	**-**	**100.3**
Effect of adopting IAS 39:-					
- Cash flow hedges remeasured to fair value	-	-	0.7	-	0.7
Opening balances restated	**81.4**	**18.9**	**0.7**	**-**	**101.0**
Arising in the year:-					
- Available-for-sale securities: net fair value gains	-	-	-	6.2	6.2
- Cash flow hedges: net fair value gains	-	-	6.9	-	6.9
Net gains not recognised in net income	-	-	6.9	6.2	13.1
Transfers from retained earnings	9.7	9.7	-	-	19.4
At 31st December 2001	**91.1**	**28.6**	**7.6**	**6.2**	**133.5**
Arising in the year:-					
- Available-for-sale securities: net fair value losses	-	-	-	(113.1)	(113.1)
- Cash flow hedges: net fair value gains	-	-	13.7	-	13.7
Transfers in the year:-					
- Transfers to net income	-	-	(9.6)	(4.4)	(14.0)
Net gains / (losses) not recognised in net income	-	-	4.1	(117.5)	(113.4)
Transfers from retained earnings	8.5	8.5	-	-	17.0
At 31st December 2002	**99.6**	**37.1**	**11.7**	**(111.3)**	**37.1**

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.

Following a change in the accounting policy for investments in subsidiaries as described in more detail in Note 34, the prior years' transfers to the compulsory and voluntary reserves have been restated in order to reflect the new accounting policy. The change in accounting policy had the effect of reducing the compulsory and voluntary reserves at 31st December 2001 by US$0.4 million each and increasing retained earnings by US$0.8 million.

17. DIVIDENDS

Dividends are not accounted for until they have been ratified at the general assembly meeting. The dividend ratified in respect of 2002 will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31st December 2003.

18. OTHER INCOME

	2002 **US$ millions**	2001 US$ millions
Dividend income	**31.5**	40.4
Profit on available-for-sale securities	**19.4**	9.4
Investment banking and management fees	**17.0**	11.7
Profit on cash flow hedges	**8.3**	-
Commissions on letters of credit and guarantee	**7.6**	7.2
Profit on foreign exchange	**6.5**	2.0
Other fee and sundry income	**3.2**	2.6
Loss on trading securities	**(5.1)**	(4.0)
Loan recoveries	**-**	1.0
	88.4	70.3

Dividend income comprised dividends received of US$5.2 million and US$26.3 million from equities and equity funds in the trading and available-for-sale security portfolios respectively (2001: US$2.1 million and US$38.3 million respectively). The funding cost in respect of the equities and equity funds is included in interest expense in the consolidated statement of income.

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

19. RESTRUCTURING COSTS

Net income for the year ended 31st December 2001 included a pre-tax charge of US$8.4 million in connection with strategic restructuring initiatives involving the reorganisation and streamlining of support functions and the realignment of certain business activities. The charge included costs associated with staff reductions and the write off of certain fixed assets. All restructuring costs were incurred during the year.

20. DEFERRED INCOME TAXES

At 31st December 2002 a deferred tax asset of US$3.2 million (2001: US$7.1 million) associated with an IAS 39-related consolidation adjustment in relation to a subsidiary company has not been recognised in the consolidated financial statements due to the uncertainty of the recovery of the tax losses against future taxable profits.

21 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:-

- Corporate and institutional banking – the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers.
- Treasury and financial markets – the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary trading and investment activities and the management of the Group's balance sheet, including funding.
- Investment management and banking – the provision of investment management and financial advisory services, including asset management and services relating to structured financing, privatisations, IPO's and mergers and acquisitions.

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

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

The business segment analysis is as follows:-

	Corporate and institutional banking US$ millions	Treasury and financial markets US$ millions	Investment management and banking US$ millions	Corporate and other US$ millions	Total US$ millions
2002					
Net interest and other income	**45.6**	**81.4**	**2.6**	**71.8**	**201.4**
Segment result	**36.3**	**62.3**	**(6.8)**	**71.8**	**163.6**
Unallocated overhead					**(77.8)**
Taxation on overseas activities					**(0.5)**
Net income after tax					**85.3**
Segment assets	**3,317.6**	**12,443.6**	**23.5**	**451.8**	**16,236.5**
Segment liabilities	**-**	**14,026.3**	**-**	**1,082.0**	**15,108.3**
Shareholders' equity					**1,128.2**
Total liabilities and shareholders' equity					**16,236.5**
2001					
Net interest and other income	67.4	48.4	6.5	89.3	211.6
Segment result	55.8	29.4	(1.3)	89.3	173.2
Unallocated overhead					(71.3)
Restructing costs					(8.4)
Taxation on overseas activities					7.0
Net income after tax					100.5
Segment assets	3,453.5	11,339.5	20.2	418.8	15,232.0

Segment liabilities	-	12,973.4	-	1,064.9	14,038.3
Shareholders' equity					1,193.7
Total liabilities and shareholders' equity					15,232.0

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

	2002 US$ millions	2001 US$ millions
GCC countries	**209.7**	188.0
Other countries	**(8.3)**	23.6
	201.4	211.6

The geographical analyses of deposits and risk assets are set out in Notes 11 and 23 respectively.

22. 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 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 of 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 commented on as follows:-

Credit risk

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

The geographical distribution of risk assets is set out in Note 23. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in Note 26 (a) while the notional and risk-weighted exposures for credit-related financial instruments are detailed in Note 26 (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 and equity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. The Group supplements daily VaR calculations with portfolio stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. It is recognised that VaR is not a measure of the absolute limit of market risk and that losses in excess of the VaR amounts will, on occasion, arise. The composition of the debt and equity trading securities is set out in Note 5. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in Note 26 (a).

  The VaR by risk class for the Group's trading positions, as calculated in accordance with the basis set out in Note 28, was as follows:-

	31.12.02 US$ millions	**2002 Average US$ millions**	31.12.01 US$ millions	2001 Average US$ millions
Interest rate risk	**4.0**	**6.1**	6.8	5.0
Foreign exchange risk	**1.0**	**1.4**	1.3	1.4
Equity risk	**1.6**	**2.8**	6.7	6.8
Total diversified risk	**3.3**	**5.3**	5.9	6.8

- Non-trading market risk: Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within

VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities is set out in Note 25. The Group does not maintain material non-trading foreign currency open positions. In general, the Group's policy is to match assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in Note 26 (a).

22. RISK MANAGEMENT (continued)

Market risk (continued)

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

Liquidity risk

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

An analysis of available-for-sale securities by rating classification is set out in Note 6 (a). The maturity profile of assets and liabilities is set out in Note 24.

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.

23. GEOGRAPHICAL DISTRIBUTION OF RISK ASSETS

	31.12.02					31.12.01
	Placements & other liquid assets	**Securities**	**Loans and advances**	**Credit-related contingent items**	**Total**	Total
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**	US$ millions
GCC	**713.3**	**1,260.5**	**2,486.6**	**1,266.7**	**5,727.1**	5,377.8
Other Middle East & North Africa	**67.2**	**127.9**	**229.0**	**64.1**	**488.2**	633.5
Europe	**1,513.4**	**3,376.2**	**349.9**	**291.0**	**5,530.5**	5,865.9
North America	**583.8**	**4,242.9**	**127.1**	**459.1**	**5,412.9**	4,230.6
Japan & other Asia	**293.9**	**358.3**	**63.2**	**160.2**	**875.6**	876.6
Latin America	**-**	**116.0**	**-**	**-**	**116.0**	140.8
	3,171.6	**9,481.8**	**3,255.8**	**2,241.1**	**18,150.3**	17,125.2

An analysis of derivative and foreign exchange instruments is set out in Note 26 (a).

24. MATURITIES OF ASSETS AND LIABILITIES

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

	Within 3 months	**4 months to 1 year**	**Years 2 and 3**	**Years 4 and 5**	**Over 5 years and other**	**Total**
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**
At 31st December 2002						
Cash and other liquid assets	**144.6**	**3.0**	**-**	**-**	**-**	**147.6**
Placements	**2,711.2**	**312.8**	**-**	**-**	**-**	**3,024.0**
Securities	**1,362.5**	**779.1**	**1,438.2**	**1,186.7**	**4,715.3**	**9,481.8**
Loans and advances	**612.0**	**702.9**	**863.1**	**642.1**	**435.7**	**3,255.8**
Fixed & other assets	**216.7**	**39.3**	**5.0**	**2.8**	**63.5**	**327.3**
Total assets	**5,047.0**	**1,837.1**	**2,306.3**	**1,831.6**	**5,214.5**	**16,236.5**
Deposits	**8,916.5**	**1,796.6**	**129.0**	**4.4**	**-**	**10,846.5**
Securities sold under agreements to repurchase	**781.3**	**1,795.4**	**-**	**-**	**-**	**2,576.7**
Securities sold but not yet purchased	**53.3**	**-**	**-**	**-**	**-**	**53.3**
Other liabilities	**259.4**	**48.5**	**38.4**	**37.7**	**242.8**	**626.8**
Term financing	**-**	**50.0**	**450.0**	**355.0**	**150.0**	

1,005.0

Shareholders' equity	**-**	**-**	**-**	**-**	**1,128.2**	**1,128.2**
Liabilities & shareholders' equity	**10,010.5**	**3,690.5**	**617.4**	**397.1**	**1,521.0**	**16,236.5**
At 31st December 2001						
Total assets	5,102.3	1,223.2	2,336.9	1,579.5	4,990.1	15,232.0
Liabilities & shareholders' equity	10,814.6	2,369.2	252.7	430.0	1,365.5	15,232.0

24. MATURITIES OF ASSETS AND LIABILITIES (continued)

The asset and liability maturities are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Counterparties each with deposits over US$10.0 million at 31st December 2002, had average deposits throughout 2002 amounting to US$9,965.5 million (2001: US$10,244 million). Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

25. INTEREST RATE RISK

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

	Within 3 months	**Months 4 to 6**	**Months 7 to 12**	**Over 1 year**	**Non-interest bearing items**	**Total**	*Effective Interest rates*
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**	**US$ millions**	**%**
At 31st December 2002							
Cash and other liquid assets	**144.6**	**1.0**	**2.0**	**-**	**-**	**147.6**	*0.99*
Placements	**2,711.2**	**63.8**	**49.0**	**200.0**	**-**	**3,024.0**	*2.08*
Trading securities	**1,053.2**	**-**	**-**	**-**	**148.2**	**1,201.4**	*4.17*
Available-for-sale securities:-							
- Fixed rate	**8.3**	**127.6**	**229.5**	**583.8**	**-**	**949.2**	*5.08*
- Floating rate	**5,950.7**	**803.0**	**48.4**	**-**	**-**	**6,802.1**	*3.31*
- Equities & equity funds	**-**	**-**	**-**	**-**	**529.1**	**529.1**	*-*
Loans and advances	**2,526.1**	**836.8**	**72.1**	**11.2**	**(190.4)**	**3,255.8**	*2.85*
Fixed & other assets	**-**	**-**	**-**	**-**	**327.3**	**327.3**	*-*
Total assets	**12,394.1**	**1,832.2**	**401.0**	**795.0**	**814.2**	**16,236.5**	
Deposits	**9,031.8**	**1,399.2**	**308.8**	**106.7**	**-**	**10,846.5**	*2.00*
Securities sold under agreements to repurchase	**2,193.6**	**383.1**	**-**	**-**	**-**	**2,576.7**	*1.98*
Securities sold but not yet purchased	**38.6**	**-**	**-**	**-**	**14.7**	**53.3**	*4.83*

Other liabilities	**-**	**-**	**-**	**-**	**626.8**	**626.8**	-
Term financing	**1,005.0**	**-**	**-**	**-**	**-**	**1,005.0**	*2.20*
Shareholders' equity	**-**	**-**	**-**	**-**	**1,128.2**	**1,128.2**	-
Liabilities & shareholders' equity	**12,269.0**	**1,782.3**	**308.8**	**106.7**	**1,769.7**	**16,236.5**	
Interest rate sensitivity gap	**125.1**	**49.9**	**92.2**	**688.3**	**(955.5)**	**-**	
Cumulative interest rate sensitivity gap	**125.1**	**175.0**	**267.2**	**955.5**	**-**	**-**	
At 31st December 2001							
Cumulative interest rate sensitivity gap	(930.7)	(243.4)	(340.8)	655.3	-	-	

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

The substantial majority of assets and liabilities reprice within one year. Accordingly there is a limited exposure to interest rate risk. The investment of the Group's net free capital through the use of fixed receive interest rate swaps and fixed rate securities represents the principal interest rate risk beyond one year. At 31st December 2002, the modified duration of these interest rate swaps and fixed rate securities was 2.0 (2001:2.36). 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 interest rate swaps and fixed rate securities was US$133,000 (2001 : US$330,000).

Based on the repricing profile at 31st December 2002, 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 1% 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$4.6 million and US$5.9 million respectively (2001: US$6.5 million and US$8.9 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 22. The market risk relating to foreign exchange and derivative trading instruments is set out in Note 26 (a).

26. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS

a) 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 and equity 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.

26. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS (continued)

a) Derivative and foreign exchange instruments (continued)

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 specifiedstock or index at a specified price or level on or before a specified future date.

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

Product analysis

	Notional amounts			Credit risk
	Trading	**Hedging**	**Total**	**amounts**
	US$ millions	**US$ millions**	**US$ millions**	**US$ millions**
At 31st December 2002				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	**1,570.0**	**2,339.1**	**3,909.1**	**14.9**
Interest rate contracts:-				
Futures	**6,440.0**	**-**	**6,440.0**	**-**
Interest rate swaps and swaptions	**741.4**	**7,184.3**	**7,925.7**	**42.8**
Options, caps and floors purchased	**3,510.1**	**15.5**	**3,525.6**	**2.0**
Options, caps and floors written	**7,237.1**	**5.0**	**7,242.1**	**-**
	17,928.6	**7,204.8**	**25,133.4**	**44.8**
Total	**19,498.6**	**9,543.9**	**29,042.5**	**59.7**
At 31st December 2001				
Total	44,565.3	6,781.9	51,347.2	286.3

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

At 31st December 2002, the Value-at-Risk of the foreign exchange and interest rate-related derivative trading contracts analysed in the table above, as calculated in accordance with the basis set out in Note 28, was US$0.2 million and US$1.0 million respectively (2001: US$0.6 million and US$0.6 million respectively). Value-at-Risk is a measure of market risk exposure and is accordingly separate and in addition to the credit risk exposure represented by the credit risk amounts in the table above.

Counterparty analysis

	31.12.02			31.12.01
Credit risk amounts	Banks	Other	Total	Total
	US$ millions	US$ millions	US$ millions	US$ millions
OECD countries	44.8	-	44.8	273.4
GCC countries	9.0	5.5	14.5	12.8
Other countries	0.4	-	0.4	0.1
	54.2	5.5	59.7	286.3

Credit risk is concentrated on major OECD-based banks.

26. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS (continued)

a) Derivative and foreign exchange instruments (continued)

Maturity analysis

Notional amounts	Year 1	Years 2 & 3	Years 4 & 5	Over 5 years	Total
	US$ millions	US$ millions	US$ millions	US$ millions	US$ millions
At 31st December 2002					
Foreign exchange contracts	3,844.6	64.5	-	-	3,909.1
Interest rate contracts	21,043.3	1,016.1	825.2	2,248.8	25,133.4
	24,887.9	1,080.6	825.2	2,248.8	29,042.5
At 31st December 2001					
Total	29,693.1	9,456.1	6,630.4	5,567.6	51,347.2

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

Fair value analysis

	31.12.02		31.12.01	
	Positive fair value US$ millions	**Negative fair value US$ millions**	Positive fair value US$ millions	Negative fair value US$ millions
Derivatives held for trading:-				
Forward foreign exchange contracts	**5.2**	**(11.5)**	2.7	-
Currency options	**-**	**-**	0.3	(0.2)
Interest rate futures	**0.2**	**(0.2)**	4.7	(0.1)
Interest rate swaps and swaptions	**12.7**	**(16.8)**	67.8	(114.4)
Interest rate options, caps and floors	**11.3**	**(2.1)**	99.0	(85.9)
	29.4	**(30.6)**	174.5	(200.6)
Derivatives held as fair value hedges:-				
Interest rate swaps	**1.7**	**(278.3)**	41.7	(132.5)
Derivatives held as cash flow hedges:-				
Interest rate swaps	**1.8**	**-**	7.6	-
Gross positive/(negative) fair value	**32.9**	**(308.9)**	223.8	(333.1)
Effect of master netting agreements	**(0.7)**	**0.7**	(108.9)	108.9
Net amount included in other assets / (other liabilities)	**32.2**	**(308.2)**	114.9	(224.2)

Significant net open positions

There were no significant derivative trading or foreign currency net open positions at 31st December 2002. At 31st December 2001, the Group had a US$21.2 million long Omani Riyal net open currency position. This related to Omani government investment security holdings which matured during 2002.

b) Credit-related financial instruments

Credit-related financial instruments include commitments to extend credit, stand-by 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 Basle

Committee on Banking Supervision.

	31.12.02 Notional principal amount US$ millions	**31.12.02** Risk-weighted exposure US$ millions	31.12.01 Notional principal amount US$ millions	31.12.01 Risk-weighted exposure US$ millions
Direct credit substitutes	**202.2**	**98.8**	139.1	107.3
Transaction-related contingent items	**607.1**	**296.6**	649.1	303.6
Short-term self-liquidating trade-related contingent items	**128.4**	**20.1**	151.3	24.0
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	**1,303.4**	**521.1**	1,443.1	539.4
	2,241.1	**936.6**	2,382.6	974.3

27. 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.

28. CAPITAL ADEQUACY

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

		31.12.02 US$ millions	31.12.01 US$ millions
Regulatory capital base			
Tier I capital:			
Shareholders' equity		**1,128.2**	1,193.7
Adjustment to exclude net fair value losses		**141.8**	42.0
Adjusted Tier I capital		**1,270.0**	1,235.7
Tier II capital:			
Subordinated loans		**150.0**	150.0
Non-specific loan provision subject to 1.25% risk-weighted exposure limitation		**153.8**	152.0
Total Tier II capital		**303.8**	302.0
Total regulatory capital base	*(a)*	**1,573.8**	1,537.7

Risk-weighted exposure

		Notional principal amount US$ millions	**Risk-weighted exposure US$ millions**	Notional principal amount US$ millions	Risk-weighted exposure US$ millions
Credit risk					
Balance sheet items:					
Cash and other liquid assets		**147.6**	**29.2**	91.2	16.0
Placements		**3,024.0**	**642.4**	2,693.6	677.5
Securities		**9,481.8**	**6,716.3**	8,648.4	6,274.9
Loans and advances		**3,255.8**	**2,957.0**	3,309.4	2,836.1
Fixed & other assets		**327.3**	**229.2**	489.4	318.8
		16,236.5	**10,574.1**	15,232.0	10,123.3
Off-balance sheet items:					
Credit-related contingent items		**2,241.1**	**936.6**	2,382.6	974.3
Foreign exchange-related items		**3,909.1**	**10.7**	3,816.9	9.1
Interest rate-related items		**25,133.4**	**12.9**	47,530.3	36.0
		31,283.6	**960.2**	53,729.8	1,019.4
Credit risk-weighted exposure			**11,534.3**		11,142.7
Market risk					
General market risk			**253.2**		558.3
Specific market risk			**518.7**		461.6
Market risk-weighted exposure			**771.9**		1,019.9
Total risk-weighted exposure	*(b)*		**12,306.2**		12,162.6
Risk asset ratio *[(a)/(b) x 100]*			**12.8%**		12.6%

In accordance with the capital adequacy guidelines of the Bank's regulator, the Bahrain Monetary Agency (BMA), gains and losses arising on the remeasurement to fair value of available-for-sale securities and derivative cash flow hedging transactions are excluded from Tier I capital with the exception of gains and losses arising on the remeasurement to fair value of equity securities classified as available-for-sale. At 31st December 2002, Tier I capital included a net fair value loss of US$2.2 million (2001: US$1.1 million) in respect of equity securities classified as available-for-sale.

The Group calculates the capital requirement for general market risk using a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risks issued by the Basle Committee in January 1996. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the BMA. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at the regulatory minimum of 3.0 (2001: 3.0) by the BMA.

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

29. 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 2002 was US$6,346.8 million (2001: US$6,670.1 million).

30. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

30. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	Book value US$ millions	Fair value US$ millions	Excess US$ millions
At 31st December 2002			
Assets			
Cash and other liquid assets	**147.6**	**147.6**	**-**
Placements with banks	**3,024.0**	**3,024.0**	**-**
Trading securities	**1,201.4**	**1,201.4**	**-**
Available-for-sale securities	**8,280.4**	**8,280.4**	**-**
Loans and advances	**3,255.8**	**3,272.2**	**16.4**
Fixed and other assets	**327.3**	**327.3**	**-**
Liabilities			
Deposits	**10,846.5**	**10,846.5**	**-**
Securities sold under agreements to repurchase	**2,576.7**	**2,576.7**	**-**
Securities sold but not yet purchased	**53.3**	**53.3**	**-**
Other liabilities	**626.8**	**626.8**	**-**

Term financing	**1,005.0**	**1,005.0**	**-**
Credit-related contingent items			**-**
Excess of net fair values over net book values			**16.4**

At 31st December 2001

Excess of net fair values over net book values	33.0

Based on the valuation methodologies outlined below, the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values as at 31st December 2002 by US$16.4 million (2001: US$33.0 million).

a) Securities

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

b) Loans and advances

The fair value of floating rate loans was principally estimated at book value less provisions for impairment. The fair value of troubled sovereign debt was based on market bid prices. The fair value of impaired loans was estimated at the recoverable amount, measured as the present value of expected future cash flows discounted based on the interest rate at the inception of the loan. The fair value of fixed rate loans was estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality. The repricing profile of loans and advances is set out in Note 25. All but US$11.2 million (2001: US$9.6 million) of loans and advances reprice within one year.

c) Term financing

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

d) Other on-balance sheet items

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

e) Credit-related contingent items

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

31. EARNINGS PER SHARE

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

	2002	2001
Net income after tax (US$ millions)	**85.3**	100.5
Weighted average number of shares in issue (millions)	**1,000.0**	1,000.0
Basic earnings per share	**US$0.09**	US$0.10

32. PRINCIPAL SUBSIDIARIES

The principal subsidiary companies were as follows:-

	Country of Incorporation	**Ownership Interest**	
		31.12.02	31.12.01
		%	%
Gulf International Bank (UK) Limited	United Kingdom	**100**	100
GIB (UK) Capital Investments Limited	United Kingdom	**100**	100
SIB Financial Advisory Services Limited	United Kingdom	**100**	100
GIBINVEST E.C.	Bahrain	**100**	100

33. AVERAGE CONSOLIDATED BALANCE SHEET

The average consolidated balance sheet was as follows:-

	2002 **US$ millions**	2001 US$ millions
Assets		
Cash and other liquid assets	**154.7**	179.8
Placements with banks	**2,911.2**	2,794.3
Trading securities	**1,378.4**	1,068.5
Available-for-sale securities	**7,954.2**	7,060.3
Loans and advances	**3,279.7**	3,656.9
Fixed & other assets	**426.4**	462.6
Total assets	**16,104.6**	15,222.4
Liabilities & shareholders' equity		
Deposits from banks	**6,608.9**	6,676.3
Deposits from customers	**4,865.4**	4,988.0
Securities sold under agreements to repurchase	**1,866.7**	965.6
Securities sold but not yet purchased	**95.2**	85.8
Other liabilities	**484.6**	471.5
Senior term financing	**876.2**	819.0
Subordinated term loans	**150.0**	71.6
Total liabilities	**14,947.0**	14,077.8
Shareholders' equity	**1,157.6**	1,144.6
Total liabilities & shareholders' equity	**16,104.6**	15,222.4

34. PARENT COMPANY

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

a) Condensed balance sheet

	At 31.12.02	At 31.12.01

	US$ millions	US$ millions
Assets		
Cash and other liquid assets	**16.1**	55.7
Placements with banks	**2,247.4**	2,662.0
Trading securities	**160.7**	170.3
Available-for-sale securities	**7,023.1**	5,273.1
Investment in GIB (UK) Limited	**245.9**	331.9
Loans and advances	**3,275.5**	3,210.3
Fixed & other assets	**214.3**	264.3
Total assets	**13,183.0**	11,967.6
Liabilities & shareholders' equity		
Deposits from banks	**4,721.3**	4,818.8
Deposits from customers	**3,375.4**	3,334.8
Securities sold under agreements to repurchase	**2,467.2**	1,319.3
Other liabilities	**485.8**	320.8
Senior term financing	**855.0**	830.0
Subordinated term loans	**150.0**	150.0
Total liabilities	**12,054.7**	10,773.7
Shareholders' equity	**1,128.3**	1,193.9
Total liabilities & shareholders' equity	**13,183.0**	11,967.6

The investment in GIBUK is accounted for based on the equity method of accounting. Prior to 2002, the investment in GIBUK was accounted for at cost. The change in accounting policy was applied retrospectively and, accordingly, the prior year comparative figures have been restated in order to reflect the new accounting policy. The change in accounting policy had the effect of reducing the carrying amount of the investment, and shareholders' equity, at 31st December 2001 by US$63.3 million. Under the equity method of accounting, the carrying amount of the investment is adjusted for both post-acquisition results and the movement in the fair value of available-for-sale securities.

34. PARENT COMPANY (continued)

b) Condensed income statement

BIOGRAPHIES: BOARD OF DIRECTORS AND SENIOR MANAGEMENT

BOARD OF DIRECTORS

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

Mr. Abdul Aziz M. Al-Abdulkader, ❶ ❷
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. Other current directorships include Middle East Capital Group, United Gulf Industries Company and National Instalment Company Ltd. He is a former Chairman of the Board of Directors of Bank Al-Jazira.

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

Dr. Hamad Bin Sulaiman Al-Bazai, ❹
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 & National Economy for Economic Affairs at the Ministry of Finance & National Economy, Kingdom of Saudi Arabia. He is a Member of the Preparatory Committee of the Supreme Petroleum Council and a Board Member of the Saudi Arabian General Investment Authority, the Human Resources Development Fund and the Southern Region Cement Company.

Mr. Mohammed Al-Shumrani, ❸ ❹
Saudi Arabian Citizen
BA in Economics, King Saud University, Riyadh and MA in Economics, University of Denver, USA. Mr. Al-Shumrani was appointed to the Board in 2001. He has been Director General of the Investment Department at the Saudi Arabian Monetary Agency (SAMA) since 1994. Previous positions at SAMA included Director, Investment Management Department from 1989-1994 and as Assistant Director, Investment Management Department from 1985-1989. Before joining SAMA in 1974, he worked at First National City Bank in Riyadh from 1969-1974. He is currently a Board Member of Petromin. He also served as a Board Member at Saudi Industrial Development Fund, Saudi Credit Bank and Saudi Tunisian Investment Development Fund.

Mr. Saker Dhaher Al-Moraikhi, ❶
Qatari Citizen
BA degree in Business Administration, Cairo University. Mr. Al-Moraikhi was appointed to the Board in 1988. He is currently Adviser at the Minister's Office, Ministry of Finance, Qatar. He commenced his career at the Ministry in 1973 and immediately prior to his current position, he was Director of the Financial Affairs Department. Mr. Al-Moraikhi is a Member of the Board of Directors of the Arab Investment Company.

Mr. Mohamed Bin Saif Al-Shamsi, ❷ ❸
UAE Citizen
MBA, Bradford University, United Kingdom. Mr. Al-Shamsi was appointed to the Board in 1997 and is currently Chairman of the Audit Committee. He is Consultant at the Minister's Office, Ministry of Finance and Industry, United Arab Emirates. Previously, he served in various senior positions at the Ministry of Finance since 1992. He represents the Ministry on the Boards of a number of organisations and financial institutions. Previous positions include Head of the Industrial Property Rights Directorate. Mr. Al-Shamsi is a former Member of the Board of Directors of the Emirates Transportation Company.

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

Mr. Mark Garvin, ❷ ❹
US Citizen
BS, Georgetown University and MBA, American University, Washington DC. Mr. Garvin was appointed to the Board in 2002. He is Chief Operating Officer of the Europe Middle East Africa region and Senior Country Officer for JPMorgan in the United Kingdom. He assumed his current position in 2001 following the merger with JPMorgan Chase. Mr. Garvin is Chairman or a Director of a number of JPMorgan entities. He is also a Director of CLS Services Ltd., British American Business Inc. and the European Securities Forum.

❶ Executive Committee Member
❷ Risk Policy Committee Member
❸ Audit Committee Member
❹ Compensation Committee Member

SENIOR MANAGEMENT

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

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

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

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

Dr. Fouad M. Sinan
Managing Director - Operations & Administration
Saudi Arabian Citizen
Ph.D. in Engineering from Purdue University, USA and ISMP/AMP and Finance for Senior Executives programmes, Harvard Business School, USA. Dr. Sinan joined GIB in 2000 as Operations and Administration Group Head. He was previously Executive Vice President in the Administration Group at Gulf Investment Corporation, Kuwait. He commenced his career in the mid 1970's with ARAMCO, Ras Tanura Construction Division, and then with the Royal Commission for Jubail & Yanbu - Jubail project. He has served as a member of the Board of Directors of Middle East Propulsion Company Ltd., Gulf Ferro Alloys Co. (SABAYEK) and National Titanium Dioxide Co. (Cristal).

GROUP CORPORATE DIRECTORY

Gulf International Bank B.S.C.

General Management

Dr. Khaled Al-Fayez
Chief Executive Officer
Matthew Snyder
Managing Director-
Merchant Banking
Bachir Barbir
Managing Director-Treasury
Mohannad Farouky
Managing Director-
Risk Management
Dr. Fouad Sinan
Managing Director-
Operations & Administration

Merchant Banking

Relationship Management - GCC

Abbas Ameeri
Head of Relationship
Management - GCC
Zafer Al Kalali
GIB Riyadh
Ali Rahimi
Saudi Arabia
M. Chandrasekaran
Project & Structured Finance
Munawar Ihsan
Syndications
Srinivas Vemparala
Oman & Qatar
Abdul Rahman Kooheji
Islamic Banking
Shahriar Khoshabi
Bahrain & Kuwait
Galal Kulaib
United Arab Emirates

Asset Management

David Waite
Head of Asset Management
Peter James
Portfolio Management-Equities
Charles Thomson
Portfolio Management-
Fixed Income
Pat Walton
Middle Office

Investment Banking

Michael Parkhouse
Head of Investment Banking
Salman Al-Deghaither
Corporate Advisory
Ian Brameld
Corporate Advisory
Ioannis Karapatakis
Corporate Advisory
Faisel Hoodbhoy
Corporate Advisory, Abu Dhabi

Private Equity

Gregga Baxter
Head of Private Equity

Financial Markets

Mohab Mufti
Head of Financial Markets
Helen Cook
FM Management
Chris Baker
Assistant Head of
Financial Markets
Uli Gerhard
Investment Grade
Corporate Debt
Kevin Matthews
High Yield Corporate Debt
Alex Veroude
Asset Backed Securities
Kevin Garrett
Assistant Head of
Financial Markets
John Benfield
Derivatives
Simon English
Equities & Convertibles
Uday Patnaik
Emerging Markets

Treasury

Adel Al-Dosseri
Foreign Exchange &
Money Markets, Bahrain
Steven Moulder
London & New York Treasury
Yousef Al-Hamdan
Riyadh Treasury
Sunil Dattani
Investment Securities
Salman Al-Zayani
Treasury Sales
Austin Sequeira
Treasury Administration
Hassan Abdul-Ghani
International
Financial Institutions

Relationship Management International

Najah Al-Aali
Head of International
Corporate Relationship
Management

Risk Management

Peter Szalay
Credit-Loans
Atef Sakr
Credit-Securities
Stephen Williams
Group Financial Controls
Fouad Masrieh
Risk Policy &
Portfolio Structure
Tony Ellingham
Financial Control - London
Peter Robinson
Credit Risk Management -
GIBUK

Operations & Administration

Abdulla Janahi
Head of Operations &
Administration
Antony Maw
Special Projects
Jamal Hijris
Human Resources -
Bahrain
Michael Osborne
Human Resources
Policy & Planning
Jameel Al-Sairafi
IT Operations Services -
Bahrain
P. K. Nambiar
IT Applications - Bahrain
Shane Panjvani
Information Security
Gordon Brooker
Operations & Administration -
London

Corporate Development

Anthony James
Head of Corporate
Development
Abdul Elah Al-Amer
Secretary to the Board

Audit & Compliance

Masood Zafar
Head of Audit & Compliance
Julian Anthony
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