



A CLEAR VISION FOR
THE FUTURE

GULF INTERNATIONAL BANK
ANNUAL REPORT 2014



GULF INTERNATIONAL BANK

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Gulf International Bank

Gulf International Bank B.S.C. (GIB) was established in the Kingdom of Bahrain in 1975, and it is licensed by the Central Bank of Bahrain as a conventional wholesale bank. The Bank is owned by the six GCC governments, with the Public Investment Fund of Saudi Arabia holding a majority stake (97.2 per cent). In addition to its main subsidiaries, London-based Gulf International Bank (UK) Ltd., and Riyadh-based GIB Capital LLC, the Bank has branches in London, New York, Al Dhahran, Riyadh and Jeddah; and was recently granted a licence for a wholesale banking branch in Abu Dhabi, and a representative office in Dubai. GIB also has a representative office in Beirut.



OUR VISION

Gulf International Bank (GIB) aims to be the international GCC bank with regional expertise, global outreach and innovative financial solutions; and to be a value-adding partner, leveraging cutting-edge technology and superior human capital.

OUR MISSION

GIB's mission is to provide innovative, convenient and customised financial products and services and, in parallel, to build and retain a reputation for trust, quality and reliability in order to establish GIB as the partner of choice and create long-term relationships. This enables the Bank to add value for its customers, be an employer of choice and meet shareholders' objectives.



Board of Directors



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



H.E. Dr. Hamad bin Sulaiman Al-Bazai
Vice Chairman
Vice Minister of Finance, Ministry of Finance
Kingdom of Saudi Arabia



Professor Abdullah bin Hassan Alabdulgader
Independent Consultant
Kingdom of Saudi Arabia



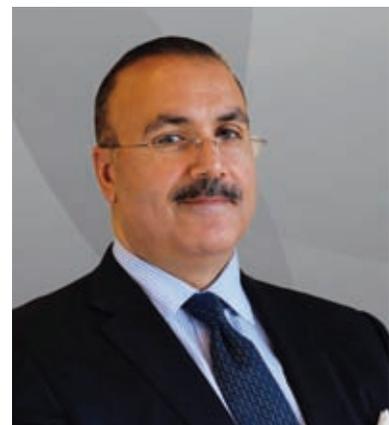
H.E. Sulaiman bin Abdullah Al-Hamdan
President
General Authority of Civil Aviation
Kingdom of Saudi Arabia



Mr. Abdulla bin Mohammed Al Zamil
Chief Executive Officer
Zamil Industrial Investment Company
Kingdom of Saudi Arabia



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



Mr. Omar Hadir Al-Farisi
Managing Member
Diyala Advisors
United States of America

Financial highlights

	2014	2013	2012	2011	2010
Earnings (US\$ millions)					
Net income after tax	85.6	121.5	117.9	104.5	100.4
Net interest income	158.0	163.1	149.4	143.8	156.2
Fee and commission income	62.9	62.0	56.7	48.5	42.2
Operating expenses	164.9	151.6	136.1	119.8	113.3
Financial position (US\$ millions)					
Total assets	21,300.2	21,156.9	17,704.8	16,788.9	15,527.7
Loans	7,931.5	8,317.2	7,110.3	6,751.8	7,510.1
Investment securities	3,944.5	3,725.8	3,560.1	3,151.7	3,067.8
Senior term financing	3,372.9	2,332.9	2,432.7	3,690.3	3,176.6
Equity	2,350.7	2,264.0	2,130.2	1,962.8	1,918.0
Ratios (per cent)					
Profitability					
Return on average equity	3.7	5.5	5.8	5.4	5.4
Return on average assets	0.4	0.6	0.7	0.6	0.6
Capital					
Risk asset ratio (Basel 2)					
– Total	19.6	18.9	20.1	23.3	24.3
– Tier 1	18.1	16.9	17.4	19.2	18.7
Equity as % of total assets	11.0	10.7	12.0	11.7	12.4
Asset quality					
Securities as % of total assets	18.9	17.9	20.7	19.3	20.3
Loans as % of total assets	37.2	39.3	40.2	40.2	48.4
Liquidity					
Liquid assets ratio	60.9	58.8	57.9	58.2	50.0
Deposits to loans cover (times) ¹	2.2	2.1	2.0	2.0	1.6

¹ Deposits include senior term financing

Credit ratings

Credit	Fitch	Moody's Ratings	Standard & Poor's	Rating Agency of Malaysia	Capital Intelligence
Long-term	A	A3	BBB+	AA1	A+
Short-term	F-1	P-2	A-2	P1	A1
Viability	BBB-	-	-	-	-
Financial strength	-	D+	-	-	BBB+
Outlook	Stable	Negative	Stable	Stable	Stable

Chairman's statement



H.E. Jammaz bin Abdullah Al-Suhaimi
Chairman

On behalf of the Board of Directors, it is my privilege and pleasure to present the annual report of Gulf International Bank (GIB) for the fiscal year ended 31st December 2014. This proved to be a pivotal year for GIB, during which we made excellent progress in implementing our pan-GCC universal banking strategy. A key highlight was undoubtedly the successful soft launch of our new retail bank, which heralds the beginning of a new chapter in GIB's development and growth.

FINANCIAL PERFORMANCE

I am pleased to report that GIB recorded a robust financial performance for 2014. Total income of US\$257.6 million for the year reflected a strong level of net interest income at US\$158.0 million; and higher contributions from fee and commission income, and foreign exchange income. Total expenses for the year increased by 9 per cent to US\$164.9 million, due primarily to costs relating to the launch of GIB's new retail banking business. Consolidated net income after tax was US\$85.6 million, compared to US\$121.5 million for the previous year. It should be noted, however, that prior year income included two exceptional, one-off items amounting to US\$21.2 million. Excluding these exceptional items, the year-on-year decrease in net income after tax was US\$14.7 million, which was largely attributable to the investment in the new retail bank.

As we predicted last year, the dilution of profitability in 2014 arises from the substantial investment in establishing a new retail bank as part of our pan-GCC universal banking strategy, and will continue through to the expected break-even of the retail bank in 2018. In addition, the Bank's initiatives to minimise the mismatch in the asset and liability maturity profile; and proactive preparations for future growth in the core corporate loan portfolio; resulted in the raising of additional term finance during 2014, which has had an impact on profitability in the short-term. However, term finance will no longer be required once more stable funding is provided by retail deposits generated by the new retail bank, thereby contributing to an improvement in profitability in the medium- to long-term.

Consolidated total assets at the year-end stood at US\$21.3 billion, compared to US\$21.2 billion at the end of 2013, with the asset profile reflecting an extremely high level of liquidity. Cash and other liquid assets, and short-term placements, totalling US\$9.0 billion, represented an exceptionally high 42 per cent of total assets. Investment securities of US\$3.9 billion largely comprised highly-rated and liquid debt securities issued by major financial institutions and regional government-related entities. Shareholders' equity at the end of 2014 stood at US\$2.4

billion compared with US\$2.3 billion at the end of the previous year. Return on average equity (RoAE) for 2014 was 3.7 per cent compared with 5.5 per cent for the previous year. RoAE has been subdued due to the Bank's business model, and we expect this to continue in the short-term. However, with the successful soft launch of the new retail bank, there is light at the end of the tunnel. Once the new business strategy achieves the planned breakeven in four years' time, we envisage returns significantly improving to double-digits. In the meantime, I would like to thank GIB's shareholders for their continued patience, understanding and support.

The Bank's funding profile continued to strengthen during 2014, with customer deposits standing at a strong US\$12.9 billion at the end of 2014. Senior term finance stood at US\$3.4 billion at the end of the year, representing a US\$1.1 billion increase over the previous year-end. The increase represented additional term borrowings of US\$1.3 billion raised to lengthen the maturity of the Bank's liabilities as part of ongoing balance sheet management initiatives. In this context, GIB issued a Saudi Riyal 2.0 billion five-year floating rate note to investors in the Kingdom of Saudi Arabia at a highly optimal spread of 72.5 basis points above SAIBOR in May 2014. The Bank's robust funding position demonstrates the continued confidence of our clients and counterparties, based on GIB's strong ownership and financial strength. The financial strength is also reflected by the Bank's Basel 2 total and tier 1 capital adequacy ratios, which stood at an exceptionally strong 19.6 per cent and 18.1 per cent respectively, at the end of the year.

INDUSTRY RECOGNITION

During 2014, the international rating agencies also endorsed their confidence in GIB's financial strength. In a significant development, Fitch Ratings affirmed GIB's long-term issuer default rating (IDR) at 'A' with a stable outlook, and its viability rating (VR) at 'bbb-'. Fitch stated GIB's ratings are driven by an extremely high probability of support from the Bank's long-standing majority shareholder, the Public Investment Fund



of Saudi Arabia, which has been clearly demonstrated in the past. The viability rating reflects the Bank's improved financial metrics, particularly its strong liquidity and capital position. The agency also noted that GIB has significantly strengthened its funding profile, including raising stable customer deposits, and improving the term structure of wholesale funding.

We regard this as an independent validation of the actions we have taken over the past four years to restructure the Bank, along with the implementation of our new business strategy. The affirmation of the viability rating also underlines Fitch's assessment of GIB on a standalone basis without shareholder support, and reflects GIB's fundamental financial strength and risk profile. Upgraded last year, this rating is one of the very few bank rating upgrades since the financial crisis. Further recognition of our business achievements was highlighted in the form of additional industry awards during 2014. GIB was named 'Best Investment Bank in Bahrain and the Middle East' and 'Safest Bank in Bahrain' by the Global Finance Awards; and 'Best Investment Bank in the Middle East' and 'Best Investment Bank in Bahrain' by the Global Banking & Finance Review Awards. In addition, GIB won the 'Islamic Investment Institution of the Year' award at the 10th annual World Islamic Funds & Financial Markets Conference.

STRATEGIC PROGRESS

I am pleased to report that we made excellent progress during the year in implementing our business strategy to transform GIB into a leading pan-GCC universal bank providing innovative customer-centric solutions. Our strategy was originally based on three main pillars. The first is the transformation of wholesale banking into a relationship-based business, with a focus on cross-selling fee-based products and services to a broader client base; the second is our entry into retail banking to provide more stable

and less-costly funding; and the third involves expansion of our asset management capabilities in the region, with new products and greater synergy between GIB (UK) Limited and GIB Capital.

The annual review of our strategy in December 2014 confirmed the validity of the direction that GIB set for itself back in 2009. Additionally, in view of current economic factors and the identification of business opportunities in the GCC, the Board decided to add Treasury and Investment Banking as two additional independent pillars of the Bank's strategy.

The key strategic highlight of 2014 was undoubtedly the highly-successful soft launch of GIB's unique technology-based retail bank in Saudi Arabia under the brand 'meem ρ'. This heralds the achievement of a new milestone in the Bank's strategic direction. In addition, GIB obtained a wholesale branch licence in Abu Dhabi and opened a new representative office in Dubai, signifying the start of the roll-out of the Bank across the GCC.

INSTITUTIONAL CAPABILITY

In order to support the realisation of our new strategy and continued business growth, we have focused on strengthening the Bank's institutional capacity. Key initiatives include the creation of a new position of Chief Operating Officer; development of a new human capital strategy; streamlining bank-wide end-to-end operating processes and procedures; and revamping the Group's worldwide information technology infrastructure. In addition, operations and IT staff from Bahrain and Riyadh were relocated and centralised at the new Saudi Arabian country headquarters at Dhahran in the Eastern Province. To ensure continued compliance with the latest rules and requirements of regulators in the various jurisdictions in which GIB operates, we also further enhanced the Bank's corporate governance and risk management frameworks.

Chairman’s statement (continued)

“The key strategic highlight of 2014 was undoubtedly the highly-successful soft launch of GIB’s unique technology-based retail bank in Saudi Arabia under the brand ‘meem ڤ’. This heralds the achievement of a new milestone in the Bank’s strategic direction.”

LOOKING AHEAD

Based on our significant achievements in 2014, we are optimistic about GIB’s prospects for next year. We have put in place solid foundations through which to support our strategic objectives to grow and develop the business across the GCC region. The decline in oil prices undoubtedly poses a challenge for the regional economies. However, the substantial accumulation of financial reserves in the region in recent years will enable GCC countries to weather the worst of the downturn in the short-term. Governments have reaffirmed their commitment to continue investing in major infrastructure projects to drive economic growth and social stability; while the IMF has retained its GDP growth forecast of around 4 per cent in 2014 and 2015 for the GCC. With the likelihood of continued global economic and market volatility, we are conscious that the year ahead will continue to be highly challenging for the regional banking industry. Nevertheless, GIB is strongly positioned to face all future challenges, and the Board has every confidence in the Bank’s management to continue implementing our new strategy and achieve our ambitious business goals.

ACKNOWLEDGEMENTS

On behalf of the Board of Directors, I would like to express my sincere appreciation for the unwavering confidence and support of our shareholders; the enduring trust and loyalty of our clients; the continued encouragement and cooperation of our counterparties; and the ongoing advice and guidance of the regulatory and supervisory bodies in the various jurisdictions in which GIB operates. I also take this opportunity to pay special tribute to the commitment and professionalism of our management and staff, and their positive attitude towards embracing change and implementing the Bank’s new strategy.

Jammaz bin Abdullah Al-Suhaimi
Chairman





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INNOVATION

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TOUCH TO START



Chief Executive Officer's report



Dr. Yahya A. Alyahya
Chief Executive Officer

I am pleased to report that 2014 proved to be a year of significant progress for Gulf International Bank (GIB). Against a backdrop of continued global economic and market volatility, and regional geo-political tensions, the Bank posted a robust overall performance. This was highlighted by continued strong revenues and business growth, and new initiatives to strengthen the support infrastructure. With the launch of our new retail bank, and expanded presence in the United Arab Emirates (UAE), we moved closer to achieving GIB's strategic objective of being a regional retail banking innovator and a leading pan-GCC universal bank.

ECONOMIC BACKGROUND

An uneven global recovery continued in 2014. The improvement in the US economy was offset by a stalling recovery in Europe, and a slowdown by emerging markets. A key theme that has emerged for advanced economies, as well as emerging and developing markets, is the urgent need for structural reforms to strengthen the potential for sustainable growth. Underlying this weaker-than-expected scenario, the IMF expects the global economy to have grown by under 3 per cent in 2014.

In contrast, GDP growth for the Gulf Cooperation Council (GCC) is forecast to be around 4 per cent for this year. The underlying fundamentals of the region remain strong, and governments have restated their commitment to continued investment in major infrastructure projects. We expect the GCC to maintain its consistent counter-cyclical fiscal policy approach since the financial crisis, and that private sector growth will continue. However, the recent decline in oil prices, which have dropped below US\$50.0 per barrel for the first time since 2009, poses a new set of challenges for GCC countries.

While healthy reserves will enable them to survive the downturn in the short-term, they will need to fund growth in a more managed manner, and ensure the efficient allocation of resources. This could entail seeking alternative sources of funding, such as the debt capital markets. GIB has consistently advocated this approach; and it is consistent with the message from prominent global forums such as the G20, IMF, World Bank and the Institute of International Finance. This would provide an opportunity for the regional banking industry and for GIB in particular.

BUSINESS ACHIEVEMENTS

I am pleased to report that we made significant progress in transforming GIB's wholesale banking business, with a focus on expanding the client base while continuing to nurture existing relationships. The Bank continued to offer innovative financial solutions, generate greater business with existing clients, and close a number of noteworthy conventional and Shariah-compliant financing deals.

GIB was the coordinating bank and facility agent for the extension of SAR10.5 billion contract financing facilities to Saudi Binladin Group for the expansion of King Abdulaziz International Airport at Jeddah; and an initial mandated lead arranger and book runner for a US\$1.85 billion revolving credit facility for Oman Oil Company, the Sultanate's energy investment arm. In addition, the Bank participated in a SAR1.0 billion Shariah-compliant financing facility for Fawaz Abdulaziz Alhokair Company.

Another key achievement in 2014 was a further increase in the cross-selling of corporate and investment banking, treasury and trade finance services and products. GIB introduced additional innovative treasury services designed to help clients hedge their market exposures, covering foreign exchange, interest rate and commodity structured products.

GIB Capital, the Group's investment banking arm based in Saudi Arabia, witnessed its most active year to date, completing a record 13 transactions and raising close to SAR50.0 billion for clients. Deals closed include some of the most high-profile transactions in the history of the region; while the volume of completed transactions resulted in GIB leading the Bloomberg league tables for equity and debt issuance by Saudi Arabian investment banks.

The most notable equity capital market deal was the SAR22.5 billion (US\$6.0 billion) initial public offering (IPO) of National Commercial Bank (NCB), for which GIB Capital acted as co-lead manager and co-financial advisor. This is the largest IPO to date in the MENA region, and the second-largest IPO in the world during 2014. In terms of debt capital market activity, GIB Capital was the joint lead manager and joint book runner on NCB's inaugural Saudi Riyal issue – a SAR5.0 billion (US\$1.3 billion) 10-year Basel III-compliant tier 2 sukuk. This is the largest sukuk of its kind to be issued in Saudi Arabia to date. GIB Capital was joint lead manager and joint book runner for a five-year US\$1.5 billion sukuk issue by the Islamic Development Bank; and a 30-year US\$1.25 billion bond issue by the Kingdom of Bahrain. GIB



Capital was also active in debt advisory, acting as joint financial advisor to Sharjah Electricity & Water Authority for refinancing a US\$500.0 million syndication Ijara facility.

GIB's asset management business, which is managed by our London-based subsidiary – GIB (UK) Limited – enjoyed another successful year, with total funds under management growing by 16 per cent to US\$13.0 billion at the end of 2014. A new five-year strategic plan was developed for asset management, which outlines the direction of the business, and how it will be further integrated into the Group's strategy to become a leading pan-GCC universal bank. In 2015, GIB UK will be working closely with GIB Capital to offer asset management products and services to clients in Saudi Arabia and across the GCC region.

STRATEGIC PROGRESS

During the year, we made significant progress in implementing GIB's new strategy to become a leading pan-GCC universal bank and a regional retail banking innovator. Without doubt, the most notable strategic development was the soft launch of the Group's new retail bank – Meem by GIB ('meem ميم') – in June 2014. This was slightly later than expected due to the sheer complexity of the project. This entailed the receipt of all necessary regulatory approvals and licences; the development of a robust risk management framework; the recruitment and training of over 200 staff; and the design and rollout of the 'meem ميم' brand. It also included the completion of three unique 'retail stores' and nine 'nano-stores'; and the go-live of the first phase of a highly-sophisticated proprietary greenfield IT infrastructure. New innovative liability products and services such as an integrated current and savings account, time deposits, a multi-currency debit card and bills payment, were launched in 2014. Asset products, including credit cards and personal loans, are planned to follow in 2015, supported by phase two of the new IT infrastructure.

GIB's pioneering online retail banking model is unique in the Middle East. It is targeted at technophiles who are accustomed to conducting their various daily transactions online. State-of-the-art technology will play a critical role in delivering superior customer service and exceptional value for money. By leveraging social media, GIB has been able to design its new retail products and services with the cooperation of potential customers through social groups. Through this concept of co-creation, innovative products such as integrated current and savings accounts and multi-currency debit cards were successfully launched in 2014 as reflected by the number of new accounts opened in the first six months exceeding expectations. Asset products including credit cards and personal loans are expected to be launched in 2015. Full details of this pioneering retail banking concept are covered separately in this Annual Report.

In another important strategic development, GIB obtained a licence from the Central Bank of the United Arab Emirates to upgrade the Abu Dhabi Wholesale Banking Representative Office to a full-fledged branch; and opened a new representative office in Dubai. This heralds the start of the Bank's planned geographic expansion strategy to establish a presence in key GCC markets. Importantly, it will enable the future roll-out of retail banking in the region, subject to the receipt of appropriate licences and regulatory approval.

SUPPORT INFRASTRUCTURE

We continued to strengthen and streamline GIB's support infrastructure in 2014. A new position of Chief Operating Officer was established, with responsibility for managing Enterprise Programme Management Office, Corporate Communications, Human Resources, Information Technology, Operations, Administration, Procurement and Operations Improvement. Particular emphasis was placed on enhancing our human capital

Chief Executive Officer's report (continued)

framework to support the Bank's vision to be the 'employer-of-choice' in the regional banking industry. Key initiatives include the development and approval of a new two-year human resources (HR) strategy; and the restructuring and expansion of the HR division. The Group's headcount has risen dramatically over the past three years as additional resources have been taken on board to facilitate implementation of the new strategy. At the end of 2014, total staff worldwide numbered 930 compared with 741 at the end of 2013 and 565 at the end of 2012.

During the year, we commenced a complete overhaul of our Group-wide IT infrastructure. This embraces a new regional and international enterprise network; a replacement core banking system for wholesale banking and treasury; and a new proprietary greenfield information technology (IT) infrastructure. The retail liability IT system went live in 2014; and user acceptance testing was conducted for the core banking system and retail asset IT system, which are planned to go live in early 2015. I would like to point out that the huge scope of these IT projects, and their concurrent implementation, is unprecedented in the regional banking industry, and constitutes an outstanding achievement.

OPERATIONAL CONSOLIDATION

Throughout the year, we focused on consolidating our regional resources to enhance efficiencies and economies of scale, and bring the Bank's operations closer to our clients. We established a new country headquarters for Saudi Arabia at Dhahran in the Eastern Province, together with new offices in Riyadh and Jeddah, which also house the new 'meem ڤ' retail banking stores. In addition, the Group's IT and Operations functions were relocated from Bahrain to Dhahran, together with treasury staff from Riyadh to Dhahran. This involved the relocation of over 400 staff – a monumental task – including more than 200 Saudi nationals who had been recruited for 'meem ڤ' and undertook their initial training in Bahrain before transferring to Saudi Arabia.

CORPORATE SOCIAL RESPONSIBILITY

We continued to implement GIB's corporate social responsibility programme during 2014. In a key initiative, the Bank hosted the 2014 IIF MENA Regional Economic Forum, which brought together senior decision makers, economists, financial experts and advisors representing member firms of the Institute of International Finance (IIF) across MENA, and global institutions active in the region. The Bank also places special emphasis on encouraging staff to participate in community-related activities. GIB continued its participation in the annual Bahrain Marathon Relay, which is a major fund-raiser for local charities, and was once again the winning financial services team.

FUTURE OUTLOOK

We are optimistic about the future prospects of GIB, and remain confident that the considerable achievements during the year will pave the way for even greater success in 2015. We have established a firm foothold in Saudi Arabia, the region's largest economy; and extended our presence in the dynamic and fast-growing market of the UAE. Our plans for 2015 include nurturing existing client relationships and expanding the mid-cap client base; and the introduction of new retail asset products for 'meem ڤ'. Next year will also witness the opening of the new wholesale banking branch in Abu Dhabi, and the go-live of our revamped Group-wide IT infrastructure. We have identified new opportunities for expanding our activities in the GCC region, and have built a strong pipeline of deals and transactions. It will be another challenging and busy year, with a continued focus on implementing our strategy, achieving our ambitious business targets, and moving closer to our vision of becoming a leading pan-GCC universal bank.

APPRECIATIONS

In conclusion, I express my sincere appreciation to our Board of Directors, and our clients and counterparties, for their respective guidance, support and encouragement during 2014. In particular, I would like to acknowledge the tremendous contribution of our management and staff. They have clearly demonstrated their willingness and determination to rise to the challenge of change, and meet the Bank's extremely ambitious strategic goals and business targets. Their energy, enthusiasm, and hard work are highly appreciated.

Dr. Yahya A. Alyahya
Chief Executive Officer

“Our plans for 2015 include nurturing existing client relationships and expanding the mid-cap client base; and the introduction of new retail asset products for 'meem ڤ'.”



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Review of operations

“The most notable equity capital markets deal was the SAR22.5 billion (US\$6.0 billion) initial public offering (IPO) by National Commercial Bank (NCB), for which GIB Capital acted as co-lead manager and co-financial advisor. This was the largest IPO to date in the Middle East and North Africa (MENA) region, and was the second-largest in the world during 2014.”

WHOLESALE BANKING

In 2014, GIB made further excellent progress in transforming its wholesale banking division into a relationship-based business, focused on cross-selling fee-based corporate and investment banking, treasury and trade finance products and services to a wider client base. This resulted in continued strong non-asset based client-related revenues, which now account for almost one quarter of total income.

Underlining the strength of the loan book, a number of noteworthy conventional and Shariah-compliant financing deals were closed during the year. GIB was the coordinating bank and facility agent for the extension of SAR10.5 billion contract financing facilities to Saudi Binladin Group for the expansion of King Abdulaziz International Airport at Jeddah, and the mandated lead arranger and book runner for a US\$1.85 billion revolving credit facility for Oman Oil Company, the Sultanate’s energy investment arm. GIB also participated in a SAR1.0 billion Shariah-compliant financing facility for Fawaz Abdulaziz Alhokair Company, and a US\$420.0 million facility for Gunvor Group. Additional deals included acting as the mandated lead arranger for aircraft financing for Flydubai, and structuring a US\$350.0 million non-recourse factoring facility for a multinational financial services corporation.

In line with GIB’s strategic objective to be a leading pan-GCC universal bank, a new representative office was established in Dubai, and a licence obtained from the Central Bank of the United Arab Emirates to upgrade the existing Abu Dhabi representative office to a full-fledged wholesale banking branch. The Abu Dhabi representative office has been serving the Bank’s corporate clients in the United Arab Emirates (UAE) for over 20 years. The decision to open an office in Dubai, a dynamic and high-potential marketplace, strongly reinforces GIB’s strategy of expanding its market presence, strengthening its network, building close relationships with clients, and providing a superior customer experience.

INVESTMENT BANKING

GIB Capital, the Group’s investment banking arm based in the Kingdom of Saudi Arabia, witnessed its most active year to date in 2014, completing a record 13 transactions and raising close to SAR50.0 billion for clients. Deals closed included some of the most high-profile transactions in the history of the region. The volume of completed transactions resulted in GIB Capital leading the Bloomberg league tables for equity and debt issuance by Saudi Arabian investment banks.

The most notable equity capital markets deal was the SAR22.5 billion (US\$6.0 billion) initial public offering (IPO) by National Commercial Bank (NCB), for which GIB Capital acted as co-lead manager and co-financial advisor. This was the largest IPO to date in the Middle East and North Africa (MENA) region, and was the second-largest in the world during 2014. GIB Capital was also co-underwriter and co-lead manager for the SAR5.6 billion (US\$1.5 billion) rights issue by Saudi Arabian Mining Company (Ma’aden), which was the largest in the Kingdom of Saudi Arabia under the new tradable rights framework. In terms of debt capital markets activity, GIB Capital was joint lead manager and joint book runner for a five-year US\$1.5 billion sukuk issue by the Islamic Development Bank, a 30-year US\$1.25 billion bond issue by the Kingdom of Bahrain, and a SAR5.0 billion (US\$1.3 billion) 10-year Basel III-compliant tier 2 sukuk by NCB. GIB Capital was also active in debt advisory, acting as joint financial advisor to Sharjah Electricity & Water Authority for refinancing a US\$500.0 million syndication Ijara facility.

ASSET MANAGEMENT

GIB’s asset management business, which is managed by its London-based subsidiary, GIB (UK) Limited (GIBUK), recorded another strong performance in 2014, with total funds under management at the end of the year increasing by 16 per cent to US\$13.0 billion. GIBUK launched a new range of cash management and money markets solutions, MENA bond and



equity portfolios, global fixed income and credit portfolios, and investment advisory services. These products and services complement GIB's proven expertise in managing passive global equity mandates, and its strong offering in emerging market fixed income. The Bank's flagship product, the Emerging Market Opportunities Fund (EMOF), continues to be ranked as a top decile performer in risk-adjusted returns over three years by Eurohedge.

A new five-year strategic plan for asset management was developed during 2014, outlining the direction of the business and how it will be further integrated into GIB's strategy to become a leading pan-GCC universal bank. In building upon group synergies, the aim is to partner with clients to provide innovative and tailored investment management solutions, initially leveraging existing skills across a number of asset classes. In 2015, GIBUK will be working closely with GIB Capital to offer asset management products and services in Saudi Arabia and across the Gulf Cooperation Council (GCC) region.

TREASURY AND INVESTMENTS

GIB's core treasury business is conducted out of Bahrain, Saudi Arabia and London. During 2014, as part of the Bank's operational consolidation exercise, the treasury function in Riyadh was relocated to the new country headquarters for Saudi Arabia in Dhahran in the Eastern Province. In addition, plans were developed to establish a full-fledged treasury function in the UAE for the first time, which will be located at the new Abu Dhabi branch. The Bank's funding profile continued to strengthen during 2014. Customer deposits stood at a strong US\$12.9 billion at the end of the year, demonstrating the continued confidence of clients and counterparties. As part of ongoing balance sheet management initiatives, GIB successfully issued a SAR2.0 billion (US\$533.0 million) five-year floating rate note to investors in the Kingdom of Saudi Arabia at a highly optimal spread of 72.5 basis points above SAIBOR. GIB continued to expand its treasury

product suite during the year in order to support strategic cross-selling initiatives in coordination with the wholesale banking business. Innovative new products to assist GCC corporate clients with their hedging requirements, include a wider range of FX and commodity option-based strategies, commodity swaps and interest rate hedging solutions, both conventional and Shariah-compliant. The Bank's investment securities portfolio, which largely represents a liquidity reserve, increased to US\$3.9 billion in 2014. This largely comprised highly-rated and liquid debt securities issued by major financial institutions and regional government-related entities.

RISK MANAGEMENT

The Bank's comprehensive risk management function comprises dedicated units covering enterprise risk management, credit, operational, market and liquidity risk, information security, economic analysis; and legal. The risk management framework, processes and procedures are reviewed annually to ensure ongoing compliance with regulatory authorities in the various jurisdictions in which GIB operates. A major activity in 2014 involved finalising all necessary approvals and licences for the launch of the new retail banking business in Saudi Arabia, together with developing a robust information security (IS) framework. IS initiatives included certification of automated teller machines (ATMs) and self-service terminals (SSTs) by the Saudi Payment Network (SPAN), and meeting requirements of the Payment Card Industry Data Security Standard (PCI DSS). In addition, a Security Operations Centre was established, and a vulnerability management system installed, while external penetration testing was successfully conducted. The Bank's business continuity planning framework was tested twice during 2014 in line with regulatory requirements. This covered the two retail banking data centres at Riyadh and Dhahran in Saudi Arabia, as well as the remote disaster recovery site, together with the data centre and disaster recovery site located in Bahrain.

Review of operations (continued)

HUMAN RESOURCES

During 2014, GIB significantly strengthened its human capital framework to support the Bank’s vision of being the ‘employer-of-choice’ in the regional banking industry. Key initiatives include the development and approval of a new two-year human resources (HR) strategy and supporting road map for implementation, and the restructuring and expansion of the HR function. A new Organisational Development unit was established, which will be responsible for supporting organisational design, employee engagement and cultural transformation. In addition, an employee satisfaction survey was conducted and an engagement task force was established to implement an approved action plan based on staff feedback.

The Bank maintained its substantial investment in training and development during the year. The Young Professional Development Programme, which recruits 20 high-calibre GCC university graduates every six months, now has 60 participants receiving theoretical and on-the-job training across the organisation. In 2014, a new GCC-sourced development programme was established, with 16 graduates from across the region forming the first of two intakes each year. GIB’s training programme during the year focused on new hire orientation, training to support the soft launch of the new retail bank, user acceptance testing for the new core banking system, and mandatory Bank-wide regulatory training.

Also during 2014, a task force was created to manage the relocation of over 400 staff. This encompassed the transfer of the Group’s IT and Operations functions from Bahrain to Dhahran in the Eastern Province of Saudi Arabia, and treasury staff from Riyadh to Dhahran. It also included the relocation to Saudi Arabia of over 200 Saudi nationals who had been recruited for the new retail bank – Meem by GIB (‘meem ريم’) – and who undertook their initial training in Bahrain. The Group’s headcount has risen dramatically over the past three years as additional resources have been recruited to facilitate implementation of the new strategy. At the end of 2014, total staff worldwide numbered 930 compared with 741 in 2013 and 565 in 2012. During the year, an online cloud-based recruitment system was introduced, and the corporate and retail banking career portals on the Bank’s website were enhanced.

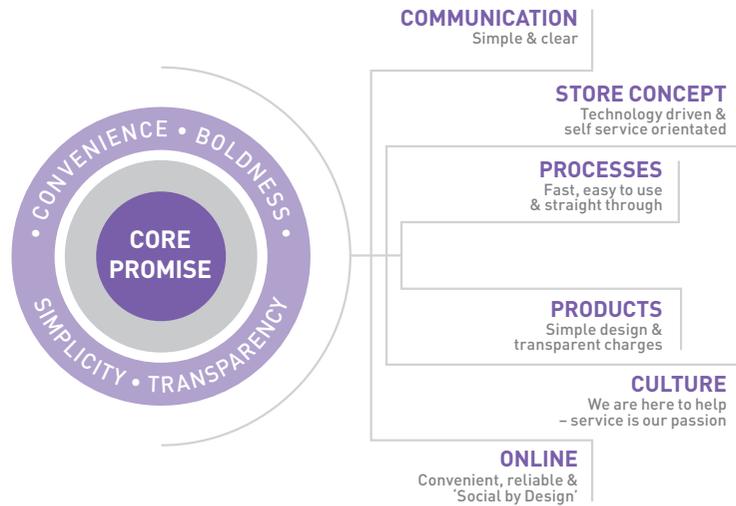
INFORMATION TECHNOLOGY

The leveraging of cutting-edge technology is a critical element in achieving the Bank’s vision, and implementing its strategy and business model. Significant progress was made in 2014 in completely overhauling the Group-wide IT infrastructure. This embraces a new regional and international enterprise network, a replacement core banking system, new front and back office systems for treasury, and new proprietary IT systems for retail banking. Key developments during the year included installing the IT framework for the new Saudi country headquarters in Dhahran, new offices in Riyadh and Jeddah, three new retail stores and nine nano-stores in Saudi Arabia, the Abu Dhabi branch and Dubai representative office, and the commissioning of a disaster recovery data centre in Dhahran. The retail liability IT system went live during 2014, and user acceptance testing was conducted for the new core banking system and retail asset IT system. Other IT-related initiatives included SPAN certification of retail banking ATMs and SSTs, and PCI DSS compliance for the retail banking card programme. In addition, IT infrastructure systems access for the new Abu Dhabi branch and Dubai representative office was finalised in readiness for inspection and approval by the Central Bank of the UAE. Significant investment was also made in improving information security in areas such as security event monitoring, penetration testing and identity management.

“In line with GIB’s strategic objective to be a leading pan-GCC universal bank, a new representative office was established in Dubai.”



Thinking Beyond... Meem by GIB ('meem ميم')



GIB PIONEERS NEW RETAIL BANKING CONCEPT

In June 2014, GIB launched its pioneering Shariah-compliant retail bank in the Kingdom of Saudi Arabia. With its unique value proposition of online and mobile banking, Meem by GIB ('meem ميم') is targeted at technophiles who are accustomed to conducting their various daily transactions electronically. Being active on social media, they are used to dialogue rather than monologue, and to voicing their opinions and being listened to. State-of-the-art technology plays a critical role in delivering freedom and convenience, superior customer service, and exceptional value for money.

BRAND VALUES

The new retail bank's name 'meem ميم' is based on the Arabic letter 'm', which is the most widely used letter in the Arabic language. The core brand values are innovation, simplicity, boldness, transparency and dynamism. The brand essence is 'straight and simple' while the brand promise is 'to excel in service ... we dare to innovate.' The brand name is supported by a flexible and dynamic calligraphic logo.

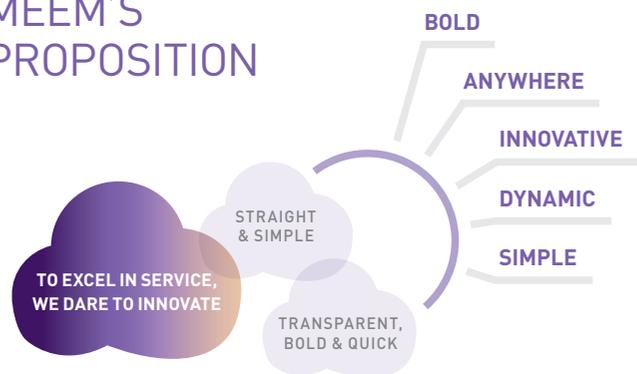
MONUMENTAL TASK

The launch took place later than expected due to the complexity of the project, for which planning started four years ago. This entailed developing an appropriate risk framework and finalising all necessary approvals and licences from regulatory bodies, and recruiting over 200 new staff with the appropriate educational backgrounds, skill sets and attitudes, followed by an intensive two-month training programme. It also involved the development of a proprietary green field IT infrastructure featuring highly-sophisticated back-end systems to deliver a simplified customer experience, and construction of three unique 'retail stores' in Dhahran, Riyadh and Jeddah, and nine 'nano-stores' in shopping malls and selected technology-related retail outlets.

CO-CREATION EXPERIENCE

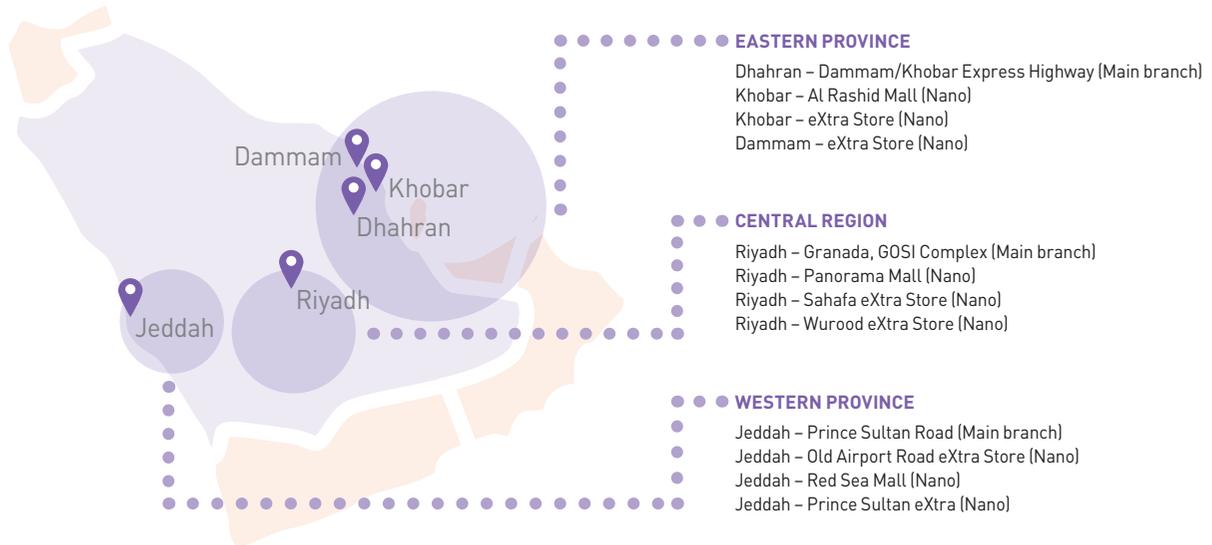
The origin of 'meem ميم' is based on a unique co-creation concept. By leveraging social media, GIB engaged with a large group of potential customers named 'Meemers' using various social media channels such as Facebook, Twitter, YouTube and Instagram. This co-creation experience – the first of its kind in the regional banking industry – helped shape not only the business model but also the innovative product and service offering, as well as the brand identity and core values.

MEEM'S PROPOSITION



Thinking Beyond... Meem by GIB ('meem ρ') (continued)

STORE LOCATIONS



SPEED AND CONVENIENCE

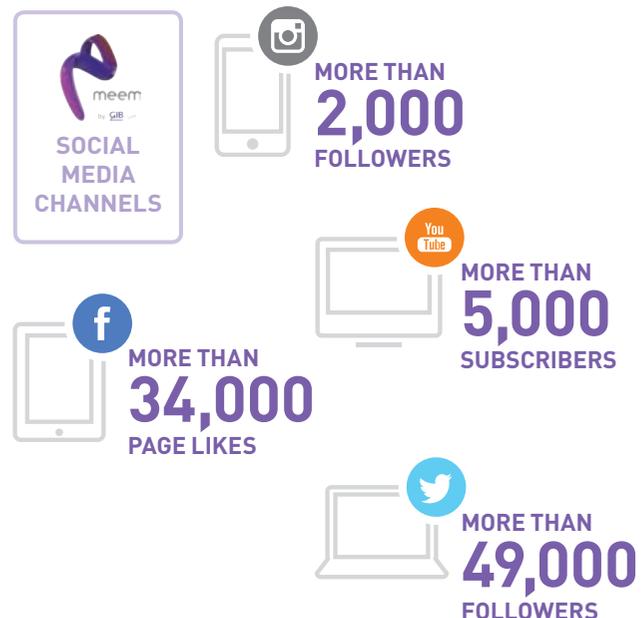
Meem by GIB ('meem ρ') offers unheralded freedom, convenience and speed. A new account can be opened in less than 10 minutes, starting with an online application via a mobile device or a self-service terminal. This is followed by a visit to a retail store or nano-store to validate identity document (ID) and supply a specimen signature, after which a debit card is issued immediately. The opening of additional accounts can be conducted entirely online, and takes a matter of seconds. Retail stores, which are completely unlike traditional bank branches, are conveniently located, along with nano-stores located in shopping malls and selected technology-related retail outlets. The opening hours for retail stores are from 9.30am to 4.30pm from Sunday to Thursday, and the nano-stores are open throughout the week from 9.00am to midnight.

PRODUCTS AND SERVICES

New innovative liability products and services were the first to be launched. These include a 'One Pack Account' that combines the benefits of both current and savings accounts, online flexible term (Murabaha) deposits, and unique multi-currency debit cards. In addition, 'meem ρ' can process bill payments on behalf of customers through a standing order facility. Other useful services include a budgeting tool that enables customers to set pre-defined spending limits for different classifications, and a financial calendar that assists customers in planning their annual finances. A range of asset products, including credit cards, personal loans and term loans based on the Tawarruq structure, are undergoing user acceptance testing prior to being introduced in 2015, supported by phase two of the new IT infrastructure.

CUSTOMER BENEFITS

Customers can choose from a broad range of channels through which to open accounts and conduct transactions. These include e-banking, a contact centre, and digital communication channels such as mobile devices, e-mail, web chat, and social media. By eliminating the costs associated with large physical branch networks, 'meem ρ' generates significant savings for the Bank, which are passed on to customers via higher rates of return for deposits or lower service charges.





Corporate social responsibility review



Dr. Yahya A. Alyahya
Chief Executive Officer, Gulf International Bank, addressing the 2014 IIF MENA Regional Economic Forum held in September 2014 in Bahrain.

GIB has an enduring commitment to support the development of the regional banking industry, and contribute to the well-being of the local community. During 2014, the Bank continued to implement its corporate social responsibility (CSR) programme in a number of different ways. These include providing career development opportunities for GCC graduates and sponsoring prestigious industry events; plus spreading health awareness and engaging in fund-raising activities for charity. Some examples of CSR initiatives undertaken by GIB during the year are highlighted below.

CAREER DEVELOPMENT

Young Professional Development Programme

The Young Professional Development Programme was initiated in January 2013 when the first batch of 20 fresh graduates came on board. Derived from GIB's core values, the programme's objectives focus on employing the best qualified candidates in the GCC region, and providing them with an opportunity to grow and become future leaders of GIB. As fresh graduates, the joining candidates have the privilege to begin their career in an environment where they can learn and understand banking and its main operations; and obtain their professional accreditation and certification at the same time.

The Programme supports the Bank's vision of being the 'employer-of-choice' in the regional banking industry. This entails attracting, nurturing and retaining a stream of talent, and creating an environment where people are motivated to deliver outstanding results and develop rewarding careers. The Programme, which recruits up to 20 high-calibre GCC university graduates every six months, now has 76 participants from Bahrain, Saudi Arabia, Kuwait and Oman undertaking a two-year programme of theoretical and on-the-job training across the organisation. Candidates are selected after successfully completing a thorough process of tests and evaluations. Once selected, the graduates undergo a number of programmes which include classroom courses, a job rotation plan within selected departments, and finally their placement.

Second Exhibition for Women and Labour

GIB is committed to providing women with employment opportunities, and to supporting them to reach their full potential and advance their careers. Under the patronage of Her Royal Highness Princess Sabeeka bin Ebrahim Al Khalifa, Wife of H.M. the King and President of the Supreme Council for Women, GIB participated in the Second Exhibition for Women and Labour in Bahrain during October 2014. This three-day event opened the door for women to meet with employers and explore job openings and career opportunities in the market.

EVENTS SPONSORSHIP

IIF MENA Regional Economic Forum

GIB hosted the 2014 IIF MENA Regional Economic Forum, which brought together senior decision makers, economists, financial experts and advisors representing member firms of the Institute of International Finance (IIF) in MENA, and global institutions active in the region. Held for the first time in the Kingdom of Bahrain during September 2014, this event marked a significant milestone in furthering the longstanding partnership and friendship between GIB and the IIF. The two-day Forum addressed the challenges of economic diversification and meaningful job creation in the oil-producing economies; and prospects for political stability and sustainable economic growth by Arab countries currently in the transition phase. It also discussed matters concerning global energy markets and the future role of the MENA oil producers in global energy supplies.

The Forum was held under the patronage of H.E. Rasheed M. Al-Maraj, Governor of the Central Bank of Bahrain. GIB Chief Executive Officer Dr. Yahya Alyahya delivered the opening address and chaired a panel discussion on 'Global and Regional Prospects'. Keynote speakers included Dr. Marwan Muasher, Vice President for Studies, Carnegie Endowment for International Peace; Dr. Ibrahim A. Al Muhanna, Advisor to the Minister, Ministry of Petroleum and Mineral Resources, Saudi Arabia; Mr. Thomas Laursen, Lead Economist, MENA, World Bank Group; Mr. Ali Aissaoui, Economic Advisor, Arab Petroleum Investments Corporation; and Mr. Adel El-Labban, Group Chief Executive Officer and Managing Director, Ahli United Bank.

Euromoney Saudi Arabia Conference

GIB was a lead sponsor of the ninth annual Euromoney Saudi Arabia Conference held in Riyadh, Kingdom of Saudi Arabia during May 2014. Entitled 'Innovation, Competition and the Changing Dynamics of Globalisation', the conference brought together government officials, policy makers, financiers and business leaders to share their thoughts and perspectives on the role of the Kingdom in the region and the global economy.



From left to right: Mr. Khalid bin Sulaiman Al-Jasser, Chief Executive Officer, Bank Al Bilad; Dr. Yahya A. Alyahya, Chief Executive Officer, Gulf International Bank; Mr. Hassan Jarrar, Chief Executive Officer, Standard Chartered Bank Bahrain; H.E. Mr. Rasheed M. Al-Maraj, Governor, Central Bank of Bahrain; Mr. George T. Abed, Senior Counselor and Director of Africa and Middle East, Institute of International Finance, at the 2014 IIF MENA Regional Economic Forum.

H.E. Dr Ibrahim Al-Assaf, Minister of Finance, inaugurated the event which featured keynote participations by H.E. Dr. Majid Al Moneef, Secretary General of the Supreme Economic Council; and Mr. Jamie Dimon, Chairman and CEO of JP Morgan. GIB Chairman H.E. Jammaz bin Abdullah Al-Suhaimi attended the first day of the conference and spent time with officials and delegates at the opening ceremony; while CEO Dr. Yahya Alyahya participated in a panel discussion. The overriding theme at the conference was the increasing importance of technology and innovation, particularly in the banking and financial sector, and also in the corporate sector. For the first time this year, a debate took place on the use of technology in finance.

HEALTH AWARENESS

World Health Day Workshop

To promote health among staff, and coinciding with World Health Day on 8th April 2014, GIB organised a general health workshop that was conducted by Dr. Nada Jawaheri from the Royal Bahrain Hospital. She provided advice on lifestyle changes, and the importance of physical exercise and healthy eating. Dr. Jawaheri also gave some practical tips on how to deal with the office environment, and how simple office exercises and habits can lead to a healthier life. Participating staff received a vital pulse check-up by the nursing team accompanying Dr. Jawaheri.

'Think Pink' Cancer Screening

GIB organised a 'Think Pink' breakfast for staff in October 2014, together with a week-long fundraising programme which included themed notebooks and mugs that employees purchased. Proceeds were donated to the Oncology/Hematology Centre (Breast Cancer Nursing Activities) at Salmaniya Hospital, Bahrain. Staff were also invited to attend an inspiring presentation about the importance of early detection of breast cancer, which was hosted by nurse and breast cancer patient, Rabab Idrees and Dr. Mariam Junaid from Salmaniya Medical Hospital.

COMMUNITY ENGAGEMENT

GIB encourages and supports staff to participate in community engagement activities. For many years, the Bank has fielded teams in two of Bahrain's most enduring annual charitable fundraising events – the Marathon Relay and the Raft Race.

The Bank participated in the 2014 Bahrain Marathon Relay, which was organised by the Bahrain Round Table in association with the Bahrain Athletics Association. The GIB team won first place in the financial institutions category, and overall third place from among 174 participating teams.

GIB also took part in the 2014 Bahrain Raft Race organised by the Rotary Club of Salmaniya. A team of 11 Bank employees took part in the open sea all men's category.

Financial review

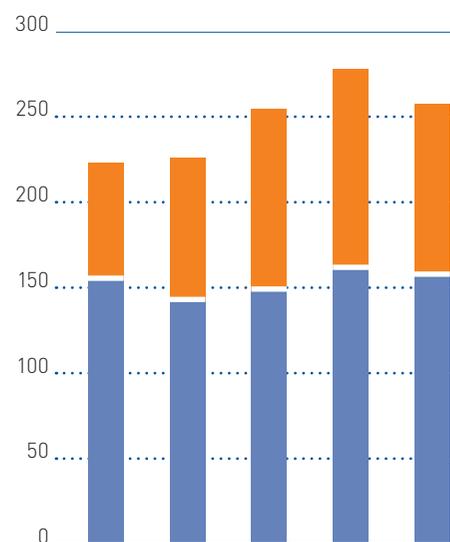
GIB recorded consolidated net income after tax of US\$85.6 million for the year ended 31st December 2014, compared to US\$121.5 million in the prior year. However, prior year income included two exceptional, one-off income items amounting to US\$21.2 million. Excluding these exceptional income items, net income was US\$14.7 million lower than the prior year principally due to a US\$13.3 million year-on-year increase in operating expenses.

The increase in expenses was attributable to the investment in the implementation of the new GCC-focused universal banking strategy and, in particular, the new retail bank which was launched for customers in the Kingdom of Saudi Arabia under the brand name 'meem ρ ' in January 2015. Net income after tax in the fourth quarter was US\$12.9 million compared to US\$20.0 million in the fourth quarter of 2013.

Total income at US\$257.6 million was US\$20.7 million or 7 per cent lower than the prior year. Excluding the exceptional income referred to above, total income was marginally up on the prior year reflecting a strong level of net interest income and higher contributions from fee and commission income, and foreign exchange income. The notable increases in the strategically important fee and commission income, and foreign exchange income reflected continued success in the cross-sell of non-asset based products and services to the Bank's customers.

Net interest income, which at US\$158.0 million represented the Bank's largest income source, was US\$5.1 million or 3 per cent down on the prior year. The year-on-year decrease was principally attributable to higher costs associated with balance sheet management initiatives that form part of an on-going programme to minimise the mismatch between the maturities of assets and liabilities. In this context, in May 2014, GIB issued a SAR2.0 billion five year floating rate note to investors in the Kingdom of Saudi Arabia at a highly optimal spread of 72.5 b.p. above SAIBOR. Net interest income derived from the wholesale corporate lending activity increased by 4 per cent over the prior year. The year-on-year increase reflected a further increase in the average loan volume as the Bank successfully reorients its lending activities from transactional-based long-term project and structured finance to relationship-based large and mid-cap corporates. This resulted in a 4 per cent year-on-year increase in the average loan volume as well as increased non-asset based customer-related activities.

GROSS INCOME DEVELOPMENT (US\$ MILLIONS)



	2010	2011	2012	2013	2014
● Non interest income	67.6	83.1	105.6	115.2	99.6
● Net interest income	156.2	143.8	149.4	163.1	158.0
Gross income	223.8	226.9	255.0	278.3	257.6



Fee and commission income at US\$62.9 million was US\$0.9 million up on the prior year, and comprised one quarter of total income. This further growth in fee and commission income reflects the success that has been achieved in the implementation of GIB's new strategic focus on non-asset based, relationship-orientated products and services, and on supporting customers' commercial and trade finance requirements. Foreign exchange income at US\$19.4 million was US\$2.0 million or 11 per cent up on the prior year. Foreign exchange income principally comprised customer-related foreign exchange revenue, and in particular revenue derived from structured products designed to assist customers in hedging their foreign exchange exposures in the current volatile markets. Trading income at US\$2.4 million compared to a US\$9.3 million profit in the prior year. However, prior year trading income included an exceptional US\$5.9 million fair value gain on a fund investment arising on the fund's recovery of a previously written off investment. Trading income principally comprised gains on an investment in a fund managed by the Bank's London-based subsidiary, GIB (UK) Limited. Other income of US\$14.9 million for the year compared to US\$26.5 million in the prior year. However, prior year other income included an exceptional US\$15.3 million recovery arising on the liquidation of a structured investment vehicle that had been written off in 2007. The remaining other income principally comprised dividends on equity investments.

Total expenses at US\$164.9 million for the year were 9 per cent up on the prior year. The year-on-year increase in expenses was attributable to the on-going investment in the implementation of GIB's new GCC-focused universal banking strategy.

NET INTEREST INCOME

Net interest income at US\$158.0 million was US\$5.1 million or 3 per cent lower than in the prior year.

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

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

Net interest income also incorporates the cost of term finance.

The year-on-year decrease in net interest income was largely attributable to: (i) a higher cost of term finance associated with a net US\$1.0 billion increase in term finance during 2014, and (ii) lower interest received on past due loans. These two factors more than offset a year-on-year increase in interest earnings derived from the wholesale lending portfolio.

Interest earnings on the wholesale lending portfolio accounted for 70 per cent of the Group's net interest income before the cost of term finance. Margin income derived from wholesale lending was 4 per cent higher than in the prior year due to a higher average performing loan volume. The average performing loan volume during 2014 was 5 per cent higher than in 2013 although average performing loan margins were 2 b.p. lower than in the prior year as a result of a contraction in credit spreads witnessed during 2014. The increase in average performing loan volumes reflected the ongoing success that has been achieved in the transformation of the Bank's wholesale banking strategy to focus on relationship-based lending to large and mid-cap corporates.

Financial review (continued)

Margin income on the investment securities portfolio accounted for 12 per cent of net interest income before the cost of term finance. The interest earnings from the investment securities portfolio were 3 per cent lower than in the prior year. The year-on-year decrease was attributable to a marginal year-on-year decrease in the average volume of investment debt securities and a 1 b.p. decrease in the average spread on the portfolio resulting from the reinvestment of maturing securities at lower prevailing spreads. The investment securities portfolio is primarily maintained as a liquidity reserve. The key factors underpinning the portfolio are therefore liquidity and quality rather than income-generating characteristics.

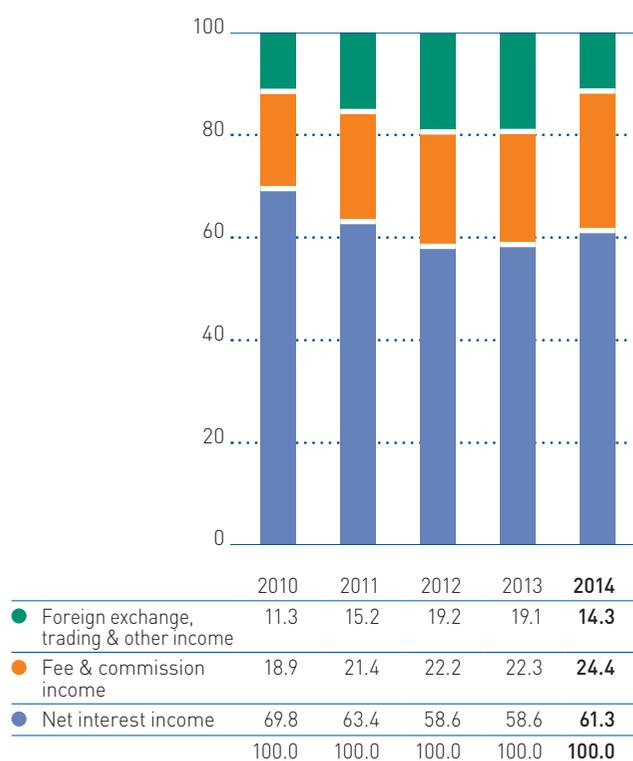
Money book earnings represent the differential between the funding cost of interest-bearing assets based on internal transfer pricing methodologies and the actual funding cost incurred by the Group. This includes benefits derived from the mismatch in the repricing profile of the Group's interest-bearing assets and liabilities. Money book earnings in 2014 accounted for 11 per cent of net interest income before term finance costs, and were 3 per cent up on the prior year. During 2014, the Group was successful in further increasing deposit average tenors while reducing its cost of funds.

Earnings on the investment of the Group's net free capital, which accounted for 9 per cent of net interest income before term finance costs, were much in line with the prior year. The net

free capital was largely invested in shorter duration government bonds reflecting the Group's view that economic conditions in the United States were not conducive to a rise in US interest rates in the short-term, although the shorter tenor fixed rate instruments provide the opportunity to reinvest on maturity at higher yields in the event that interest rates rise in the short- to medium-term as a result of a more constructive outlook for the US economy. At the end of 2014, more than half of the Group's net free capital was invested in shorter duration fixed rate instruments, generating an enhanced return over short-term interest rates. Earnings on the net free capital in 2014 and 2013 were also negatively impacted by the historically low short-term US interest rates prevailing throughout both years. A rise in US interest rates would have a direct beneficial impact on the Group's interest earnings.

The cost of term finance increased in 2014 as a result of new term finance facilities that were raised in advance of the maturity of a SAR3.5 billion (US\$933.3 million) bond in April 2015, as well as additional term finance that is required to support planned future growth in the loan portfolio. The Group continues to minimise its previous reliance on funding longer tenor assets with short-term deposits, and the associated liquidity and refinancing risk, with proactive actions having been taken over the previous five years to raise new term finance to minimise this undue risk. As a result, at 31st December 2014, the volume of illiquid assets or assets maturing beyond one year that were funded by non-sticky or short-term deposits represented less than 5 per cent of non-sticky customer deposits. The remaining customer deposits and all bank deposits therefore funded shorter tenor or liquid assets. This effectively addresses one of the key focuses of the new Basel 3 regulatory guidelines whereby banks will have less ability to fund longer tenor assets with shorter tenor wholesale deposits. The initiatives to reduce the Group's exposure to liquidity risk resulted in a US\$51.6 million or 25 per cent reduction in the Group's net interest income in 2014.

GROSS INCOME COMPOSITION (%)



NON-INTEREST INCOME

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

Fee and commission income at US\$62.9 million was US\$0.9 million higher than in the prior year. An analysis of fee and commission income with prior year comparatives is set out in note 22 to the consolidated financial statements. Commissions on letters of credit and guarantee at US\$32.1 million were the largest source of fee-based income.

A US\$0.9 million or 3 per cent year-on-year increase in commissions on letters of credit and guarantee reflected an enhanced focus on supporting customers' commercial and trade finance requirements. Investment banking and management fees were US\$27.9 million for the year, thereby representing the second largest contribution to, and 44 per cent of, fee and commission income. This income category comprises fees generated by the Group's asset management, fund management, corporate advisory, debt and equity capital markets, and underwriting activities. Investment banking and management fees were US\$0.7 million higher than the prior year level and incorporated

Financial review (continued)

fees derived from a number of debt and equity capital market mandates during the year, as commented on in more detail in the Review of Operations section of the Annual Report. As referred to in note 35 to the consolidated financial statements, assets held in a fiduciary capacity amounted to US\$13.0 billion at 31st December 2014 representing a US\$1.8 billion or 16 per cent increase over the prior year. Loan commitment fees at US\$2.0 million were US\$0.5 million lower than in the prior year with a focus on the utilisation by customers of their commitment facilities.

Foreign exchange income at US\$19.4 million for the year was US\$2.0 million up on the prior year level. Foreign exchange income principally comprised income generated from customer-initiated foreign exchange transactions that were offset in the market with matching transactions. Accordingly, there is no market risk associated with the transactions that contribute to this material source of income. The strong foreign exchange earnings reflected the success achieved in the cross-selling of innovative products to meet customers' needs and requirements, and the development of new products to meet those needs. A growing demand is being witnessed for the products as customers experience the benefits derived from the new products in assisting them to effectively manage and hedge their currency exposures. Importantly, during 2014 the

Group experienced repeat business from new clients for these innovative and effective foreign exchange products. The Bank is nevertheless continuing to expand its customer base to create a broader and a more desirable diversification of earnings from these products.

The Group's various trading activities recorded a US\$2.4 million profit for the year compared to a US\$9.3 million profit in the prior year. Trading income is reported inclusive of all related income, including interest income, gains and losses arising on the purchase and sale, and from changes in the fair value of trading securities, dividend income, and interest expense, including all related funding costs. An analysis of trading income is set out in note 24 to the consolidated financial statements. As referred to in note 24 to the consolidated financial statements, trading income in 2013 included an amount of US\$5.9 million in relation to a recovery of an underlying investment in a fund managed by the Group. The amount had been written off in previous years. Excluding this one-off item, trading income in 2014 principally comprised profits recorded on managed funds. The investment in managed funds represented an investment in an emerging market government-related debt fund managed by GIBUK. The fund, the Emerging Markets Opportunities Fund, generated a 1.2 per cent return in 2014.

KEY PROFITABILITY DRIVERS

DRIVER	2014	2015 AND BEYOND
Loan volume	 Increase in average loan volume: +\$0.4 billion	 Planned increase in 2015 and beyond to target level of \$10 billion
Loan margins	 Continued increase in core loan portfolio margins by replacement of maturing lower margin loan facilities with higher margin large and mid-cap corporates	 Continued increase in loan margins by replacement of lower margin lending with higher margin mid-cap corporates
Income on net free capital	 Yields remained at same low level as in 2013	 Rising interest rate environment in context of rising inflation
Term finance cost: liquidity risk cost	 \$1.4 billion of new term financing ahead of \$1.0 billion maturity in 2015	 New term finance to be raised in the short-term but replaced by retail deposits in the medium- to long-term
Fee and commission income	 Focus on cross-selling of non-asset based products and services, e.g. investment banking services, asset management and private equity funds	 Focus on cross-selling of non-asset based products and services, e.g. investment banking services, asset management and private equity funds
Foreign exchange income: customer-related business	 Continued focus on cross-selling of treasury products and development of new products to assist customers in hedging their market risk exposures	 Continued focus on cross-selling of treasury products and development of new products to assist customers in hedging their market risk exposures
Overhead	 Continued investment relating to retail bank launch in 2015	 Continued investment relating to retail bank launch in 2015, and the development of the Bank's strategic initiatives
Loan provisions	 Specific provisioning requirements largely reallocated from non-specific provision buffer	 Any specific provisioning requirement to be reallocated from the non-specific provision buffer

  Higher profitability   Lower profitability  Unchanged profitability

Financial review (continued)

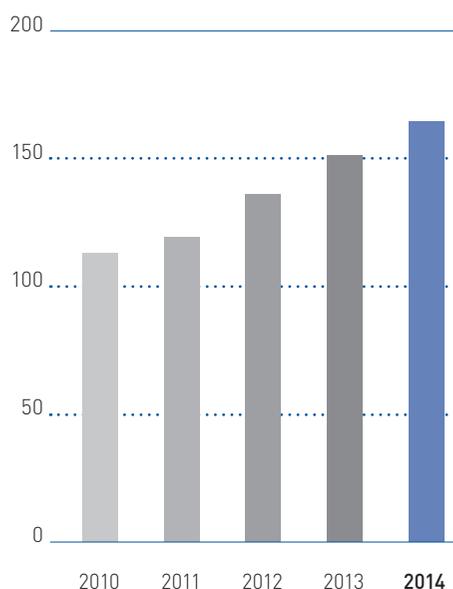
Other income of US\$14.9 million was recorded for the year. An analysis of other income is set out in note 25 to the consolidated financial statements. Other income principally comprised US\$9.5 million of dividends received from equity investments classified as fair value through other comprehensive income (FVTOCI) and US\$3.8 million of recoveries of previously written off assets. Prior year income of US\$26.5 million included an exceptional US\$15.3 million recovery arising on the liquidation of a structured investment vehicle that was written off in 2007.

OPERATING EXPENSES

Operating expenses at US\$164.9 million were US\$13.3 million or 9 per cent up on the prior year. The year-on-year increase was the result of costs associated with the implementation of the Group's new universal banking strategy.

Staff expenses, which at US\$115.4 million accounted for more than two-thirds of total operating expenses, were US\$14.1 million or 14 per cent up on the prior year. The year-on-year increase was attributable to an increase in headcount during 2014. The Group's total headcount at 31st December 2014 of 930 staff was 189 higher than at the end of 2013. The increase in headcount reflected an enhancement of resources in business areas and certain support functions, as well as the business build teams for the new retail bank. The headcount at 31st December 2014 included 201 retail banking front office staff, representing an increase of 108 compared to the 2013 year end.

EXPENSES DEVELOPMENT (US\$ MILLIONS)



Operating expenses	113.3	119.8	136.1	151.6	164.9
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Premises expenses at US\$15.7 million were US\$1.8 million or 13 per cent up on the prior year. This was due to rent and depreciation costs relating to the Group's new Kingdom of Saudi Arabia Head Office premises located in Dhahran in the Eastern Province of Saudi Arabia, and new premises for the Central and Western Province main branches to accommodate the new retail bank stores.

Other operating expenses at US\$33.8 million were US\$2.6 million or 7 per cent lower than in the prior year. The year-on-year decrease was due to one-off expenses incurred in 2013 relating to the implementation of the new business strategy and, in particular, costs relating to specialist external consultancy advisors.

PROVISIONS

Following prudent provisioning actions in previous years in anticipation of a higher level of corporate defaults in the weakening economic environment at that time, net provisioning requirements in 2014 were limited.

In 2014, there was a US\$5.8 million net provision charge comprising a US\$10.3 million provision charge for loans and a US\$4.5 million release for investment securities.

The US\$10.3 million loan provision charge comprised specific provisions that were aligned with new provisioning guidelines proposed by the Saudi Arabian Monetary Agency (SAMA) and similar guidelines set out in a consultation paper issued by the Central Bank of Bahrain (CBB). The new provisioning guidelines require specific provisions to be determined based on the period that credit facilities have been past due, with a 100 per cent specific provision required for credit facilities that are more than 360 days past due. GIB's specific and non-specific loan provisions at 31st December 2014 were fully compliant with these new provisioning guidelines in advance of their implementation dates. In addition, US\$20.0 million was reallocated from the non-specific provision to specific provisions in relation to a number of impaired loan facilities for which new specific provisions were required in accordance with the SAMA and CBB provisioning guidelines.

The US\$4.5 million investment security provision release arose on an adjustment to the historical loss estimate to reflect the effects of current conditions in relation to the investment-grade rated debt securities. The probabilities of default applied in the calculation of the collective provisions for impairment of investment securities at 31st December 2014 nevertheless continued to reflect stressed probabilities of default and exceeded prevailing default levels.

Financial review (continued)

CAPITAL STRENGTH

Total equity amounted to US\$2,350.7 million at 31st December 2014. At the 2014 year end, the ratio of equity and tier 1 capital to total assets were 11.0 per cent and 10.8 per cent respectively, ratios that are high by international comparison.

A US\$86.7 million increase in total equity during 2014 comprised the net of the US\$85.6 million profit for the year, a US\$6.7 million net increase in the fair value of derivative cash flow hedges and equity investments classified as FVTOCI, and a US\$5.6 million decrease in equity arising on the remeasurement of the defined benefit pension fund of the Group's London-based subsidiary, GIBUK.

With a total regulatory capital base of US\$2,510.1 million and total risk-weighted exposure of US\$12,782.1 million, the risk asset ratio calculated in accordance with the Central Bank of Bahrain's Basel 2 guidelines was 19.6 per cent while the tier 1 ratio was a particularly strong 18.1 per cent. In accordance with international regulatory guidelines, the fair value adjustments to equity arising under IFRS 9 in relation to derivative cash flow hedges are excluded from the regulatory capital base. Unrealised gains and losses on equity investments classified as FVTOCI are included in the regulatory capital base although unrealised gains are limited to 45 per cent of the unrealised revaluation gains. The Group's regulatory capital base is enhanced by subordinated term financing facilities. The amount included in tier 2 capital at 31st December 2014 in respect of subordinated term finance was US\$30.0 million. This was net of a discount of US\$447.8 million

for subordinated term finance that is within five years of its final contractual maturity date. The subordinated term financing facilities are approved for inclusion in tier 2 capital for capital adequacy purposes by the Group's regulator, the Central Bank of Bahrain.

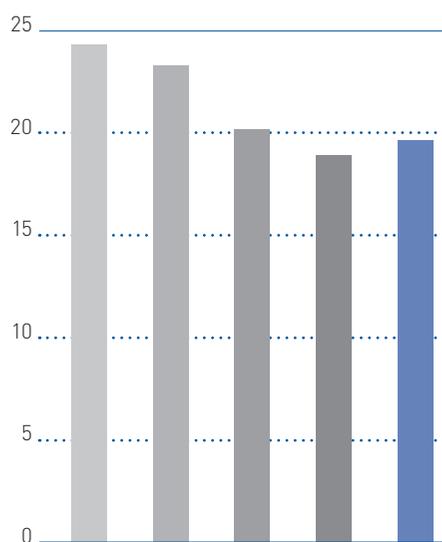
At 31st December 2014, the regulatory capital base, excluding subordinated term financing, amounted to US\$2,480.1 million. This level of regulatory capital would support an additional US\$3.75 billion of 100 per cent risk-weighted assets while still maintaining the Group's target minimum risk asset ratio of 15 per cent. The Group therefore has more than sufficient regulatory capital to support future growth plans.

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

The Central Bank of Bahrain adopted the Basel 3 regulatory capital framework with effect from 1st January 2015. The Basel 3 framework revises the definition of regulatory capital. The application of the Basel 3 regulatory capital framework on the risk asset ratios at 31st December 2014 would have resulted in a slight decrease in the total regulatory capital base by US\$27.3 million and a US\$21.3 million increase in the tier 1 capital base. In addition, total risk-weighted exposure would have increased by US\$35.4 million. The resultant Basel 3 total risk asset ratio and tier 1 ratio would have been 19.4 per cent and 18.2 per cent respectively. The adoption of the new Basel 3 regulatory capital framework accordingly has a very limited impact on the Bank's regulatory capital ratios.

The Basel 2 Pillar 3 report set out in a later section of the Annual Report provides further detail on capital adequacy and the Group's capital management framework. The Group's policies in relation to capital management are set out in note 27.5 to the consolidated financial statements. As described in more detail in the note, the Group's policy is to maintain a strong capital base so as to maintain investor, counterparty and market confidence and to sustain the future development of the Group's business.

RISK ASSET RATIO (%)



	2010	2011	2012	2013	2014
Risk asset ratio	24.3	23.3	20.1	18.9	19.6

Financial review (continued)

ASSET QUALITY

The geographical distribution of risk assets is set out in note 28 to the consolidated financial statements. The credit risk profile of financial assets, based on internal credit ratings, is set out in note 27.1(b) to the consolidated financial statements. This note demonstrates that 83 per cent of all financial assets, comprising liquid assets, placements, securities and loans, were rated 4- or above, i.e. the equivalent of investment-grade rated.

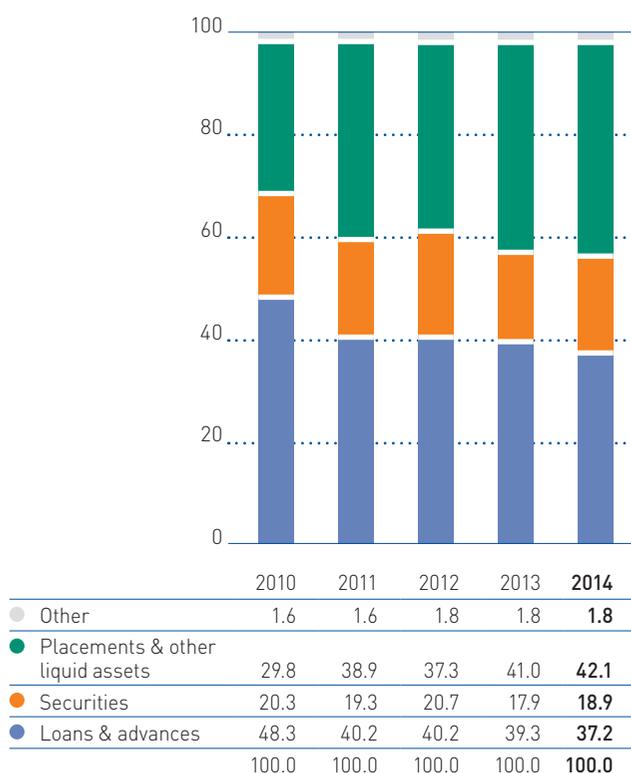
Further assessment of asset quality can be facilitated by reference to note 37 to the consolidated financial statements on the fair value of financial instruments. Based on the valuation methodologies set out in that note, the net fair values of all on- and off-balance sheet financial instruments at 31st December 2014 were not significantly different to their carrying amounts.

At the 2014 year end, cash and other liquid assets, reverse repos and placements accounted for 42 per cent of total assets, investment securities accounted for 19 per cent, while loans and advances represented 37 per cent.

Investment Securities

Investment securities totalled US\$3,944.5 million at 31st December 2014. The investment securities portfolio primarily represents the Group's liquidity reserve and accordingly, principally comprises investment-grade rated debt securities issued by major international and regional financial institutions and government-related entities.

ASSET MIX BY CATEGORY (%)



Investment securities comprise two types of debt security portfolios and a limited investment in equities and equity funds. The larger debt security portfolio comprises floating rate securities or fixed rate securities that have been swapped to yield constant spreads over LIBOR. These accounted for US\$2,090.6 million, or 57 per cent, of the total investment debt securities at the 2014 year end. The smaller debt security portfolio represents the investment of the Group's net free capital in fixed rate securities. This portfolio amounted to US\$1,546.3 million at the end of 2014 and comprised investments in OECD and GCC government-related bonds. The Group had no exposure to troubled eurozone government debt, i.e. no exposure to Greek, Irish, Italian, Portuguese or Spanish government debt.

Equity investments at the end of 2014 amounted to US\$307.6 million. Equity investments at 31st December 2014 included listed equities amounting to US\$174.8 million received in settlement of a secured past due loan. The remaining equity investments largely comprised private equity-related investments.

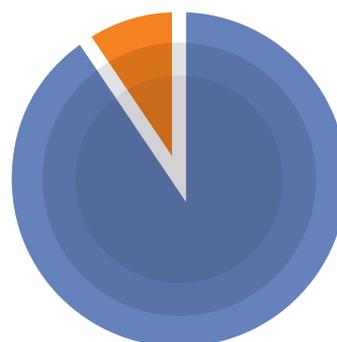
An analysis of the investment securities portfolio by rating category is set out in note 9.1 to the consolidated financial statements. US\$3,298.3 million or 91 per cent of the debt securities at the 2014 year end were rated A- / A3 or above. Based on the rating of the issuer, a further US\$338.6 million or 9 per cent of the debt securities represented other investment-grade rated securities. Thus, all debt securities comprised investment-grade rated securities.

The fair value of investment debt securities at 31st December 2014 was US\$3,657.2 million. The fair value was accordingly US\$20.3 million higher than amortised cost. The higher fair value compared to the amortised cost of the investment debt securities reflected the high quality and high ratings of the securities.

There were no past due or impaired investment securities at 31st December 2014.

INVESTMENT DEBT SECURITIES RATING PROFILE

	US\$ millions	%
● AAA to A- / Aaa to A3	3,298.3	90.7
● BBB+ to BBB- / Baa1 to Baa3	338.6	9.3
	3,636.9	100.0



Financial review (continued)

Loans and Advances

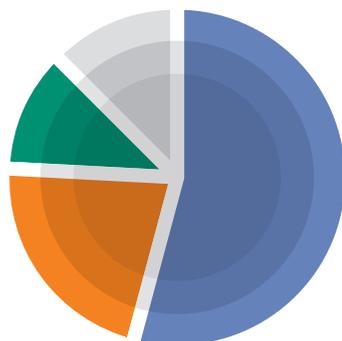
Loans and advances amounted to US\$7,931.5 million at the 2014 year end. This represented a US\$385.7 million decrease compared to the 2013 year end. As is evident from note 40 to the consolidated financial statements, the average volume of loans and advances during 2014 was US\$8,205.4 million, being US\$323.4 million or 4 per cent higher than the average volume during 2013. However, a number of loan repayments towards the end of 2014 resulted in a lower loan volume at 31st December 2014 compared to the 2013 year end. 94 per cent of the loan portfolio at the 2014 year end represented lending within GIB's core market in the GCC states.

Based on contractual maturities at the balance sheet date, 54 per cent of the loan portfolio was due to mature within one year while 76 per cent was due to mature within three years. Only 12 per cent of loans were due to mature beyond five years. Details of the classification of loans and advances by industry are set out in note 10.2 to the consolidated financial statements while the geographical distribution of loans and advances is contained in note 28. At 31st December 2014, 24 per cent of the gross loan portfolio comprised exposure to the energy, oil and petrochemical sector. This reflects the Group's previous strategic focus on project finance and syndicated lending in the GCC states.

The credit risk profile of loans and advances, based on internal credit ratings, is set out in note 27.1(b) to the consolidated financial statements. US\$4,801.4 million or 61 per cent of total loans were rated 4- or above, i.e. the equivalent of investment grade-rated. Only US\$9.4 million of loans and advances, net of provisions for impairment, were classified as individually impaired. Individually impaired loans represent loans for which there is objective evidence that the Group will not collect all amounts due in accordance with the contractual terms of the obligation. Therefore, 99.9 per cent of loans and advances were not individually impaired.

LOAN MATURITY PROFILE

	US\$ millions	%
● Year 1	4,309.5	54.3
● Years 2 & 3	1,727.0	21.8
● Years 4 & 5	923.4	11.6
● Over 5 years	971.6	12.3
	7,931.5	100.0



Total loan loss provisions at 31st December 2014 amounted to US\$601.1 million. Counterparty specific provisions amounted to US\$453.1 million while non-specific provisions were US\$148.0 million. Total provisions of US\$601.1 million represented 128 per cent of the gross book value of past due loans. There was accordingly a significant buffer of provisions in excess of the volume of past due loans.

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

Non-specific loan provisions at 31st December 2014 amounted to US\$148.0 million, representing a high 1.8 per cent of non-specifically provisioned loans. The probabilities of default applied in the calculation of the non-specific provisions at 31st December 2014 equated to circa. two and a half times the current level of probabilities of default, exceeding the previous highest corporate default rates witnessed in July 1991. The default rates applied in the calculation of the non-specific loan provision and the resultant provisioning levels for senior, unsecured exposure by internal rating category were as follows:-

Internal rating grade	Probability of default (PDs) %	Senior, unsecured provisioning level %
1	0.03	-
2+	0.03	-
2	0.03	-
2-	0.05	-
3+	0.15	0.1
3	0.20	0.1
3-	0.30	0.2
4+	0.62	0.4
4	0.88	0.5
4-	1.08	0.6
5+	1.88	1.1
5	2.90	1.7
5-	5.18	3.1
6+	8.23	4.9
6	23.28	14.0
6-	32.88	19.7
7	69.68	41.8

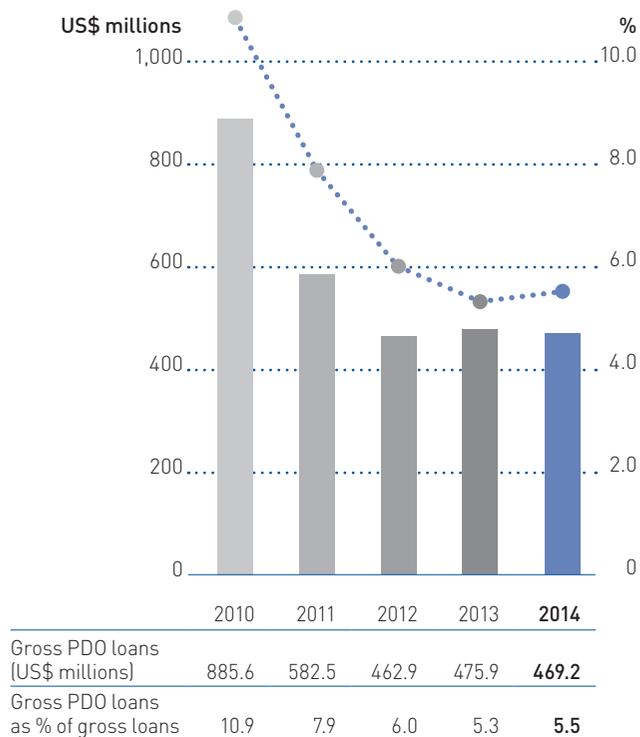
The provisioning level is based on a Loss Given Default (LGD) of 60 per cent for senior, unsecured exposure.

Financial review (continued)

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

The gross and net book values of past due loans at 31st December 2014 amounted to US\$469.2 million and US\$16.1 million respectively. The specific provisioning coverage for past due loans was therefore 97 per cent. Past due loans are defined as those loans for which either principal or interest is over 90 days past due. Under IAS 39, interest on impaired loans should be recognised in income based on the net book value of the loan and the interest rate that was used to discount the future cash flows for the purpose of measuring the recoverable amount. However, in accordance with guidelines issued by the Group's regulator, the CBB, interest on past due loans is only to be recognised in income on a cash basis. In view of the Group's high provisioning coverage for impaired loans, the difference between the two bases of accounting is not material.

PDO LOAN DEVELOPMENT



Other Asset Categories

Cash and other liquid assets, amounting to US\$2,472.6 million at the 2014 year end, are analysed in note 5 to the consolidated financial statements. They principally comprised cash and balances with central banks and banks, government bills, and certificates of deposits held for liquidity management purposes.

Placements totalled US\$5,180.5 million at the 2014 year end and were well diversified by geography as illustrated in note 28 to the consolidated financial statements. Placements were largely with GCC, European and North American bank counterparties, representing the Group's principal operating locations. Placements represented 24 per cent of total assets at the 2014 year end. A high level of placements was being maintained in the prevailing uncertain and volatile market environment. At the end of 2014, placements were supplemented by US\$1,305.2 million of securities purchased under agreements to resell. These represented collateralised placements, thereby reducing the Group's risk exposure to the financial institution sector.

Trading securities at US\$72.7 million largely comprised investments in managed funds, providing exposure to emerging market government-related debt.

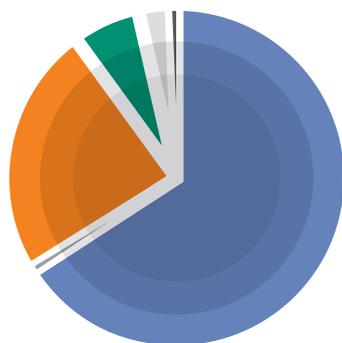
Risk Asset and Commitment Exposure

Risk asset and commitment exposure at 31st December 2014 amounted to US\$24,883.0 million. Risk assets and commitments comprise all assets included in the balance sheet (with the exception of other assets) and credit-related contingent items. As referred to earlier, an analysis of risk asset and commitment exposure by category and geography is contained in note 28 to the consolidated financial statements. As is evident from this note, US\$16,406.5 million or 66 per cent of total risk assets and commitments represented exposure to counterparties and entities located in the GCC states. The remaining risk asset exposure largely represented short-term placements with major European and North American banks. An analysis of derivative and foreign exchange products is set out in note 31 to the consolidated financial statements while a further analysis of credit-related contingent items together with their risk-weighted equivalents is contained in note 32.

Financial review (continued)

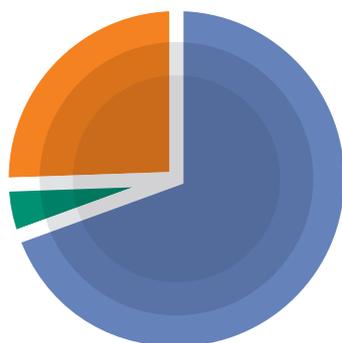
RISK ASSET AND COMMITMENT EXPOSURE

	US\$ millions	%
● GCC	16,406.5	65.9
● Other MENA	46.9	0.2
● Europe	5,962.8	24.0
● North America	1,619.6	6.5
● Asia	791.6	3.2
● Latin America	55.6	0.2
	24,883.0	100.0



DEPOSITS – GEOGRAPHICAL PROFILE

	US\$ millions	%
● GCC countries	9,856.0	69.7
● Other MENA	674.8	4.8
● Other countries	3,607.1	25.5
	14,137.9	100.0



FUNDING

Bank and customer deposits at 31st December 2014 totalled US\$14,137.9 million. Customer deposits amounted to US\$12,897.8 million at the 2014 year end, representing 91 per cent of total deposits. Bank deposits at 31st December 2014 amounted to US\$1,240.1 million, representing only 9 per cent of total deposits.

Total deposits are analysed by geography in note 13 to the consolidated financial statements. US\$9,856.0 million or 70 per cent of total deposits were derived from counterparties in GCC countries. Deposits derived from non-MENA countries, principally Europe, amounted to US\$3,607.1 million or 26 per cent of total deposits. The deposits from counterparties in non-MENA countries largely related to deposit activity by GIBUK. These deposits do not represent a core funding source for the Group. This compares to placements, reverse repos and other liquid assets with non-MENA counterparties of US\$5,193.3 million and are placed on a short-term basis in the money market. The Group is therefore a net placer of funds in the international interbank market, and accordingly has no net reliance on the international interbank market.

Securities sold under agreements to repurchase (repos) were US\$618.0 million at 31st December 2014. The Group utilises its high quality and highly rated investment securities to raise funding on a collateralised basis where effective from a cost and tenor perspective, as well as constantly validating its ability to repo the securities as part of the Group's liquidity contingency plans.

Senior term financing at 31st December 2014 totalled US\$3,372.9 million. Term finance and equity represented 171 per cent of loans maturing beyond one year. New senior term finance of US\$1,405.2 million was raised during 2014. The new term finance comprised a SAR2.0 billion (US\$533.0 million) five year floating rate note issued to investors in the Kingdom of Saudi Arabia at a highly competitive spread of 72.5 b.p. above SAIBOR, in addition to a number of term deposits raised from the Bank's customer base.

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

Corporate governance statement

“The Board establishes the objectives of the Bank, the adoption and annual review of strategy, the management structure and responsibilities, and the systems and controls framework.”

SOUND GOVERNANCE PRACTICES

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

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

In 2010, when the Central Bank of Bahrain (“CBB”) introduced new corporate governance requirements for banks in Bahrain, GIB had already put in place many measures that are hallmarks of good corporate governance practices, such as comprehensive mandates for the Board of Directors (“Board”), for directors and for Board committees, a Code of Conduct (Code on Conduct, Ethics and Avoiding Conflicts of Interest) in both English and Arabic published on the Bank’s website, a detailed Corporate Policy Manual and operating policies that anticipated the CBB’s new requirements.

In 2011, GIB adopted additional measures that included, amongst other things, a new Board Charter, updated mandates for the Board committees, a new Whistle Blowing Program that enhances the whistle-blowing provisions already existing in the GIB’s Code of Conduct, a review of the classification of directors and a realignment of Board committees.

In 2012, when the Board reassessed its composition and reconstituted its committees, the corporate governance responsibilities vested under the Audit Committee was no longer meeting the minimum independent membership requirements.

As a result, a dedicated Corporate Governance Committee was established by the Board in February 2013. The Corporate Governance Committee mandate was later approved by the Board in April 2013.

In 2014, the CBB introduced new requirements on sound remuneration of approved persons and material risk-takers and were effective from 1st July 2014. GIB arranged to take the necessary steps to fully comply with these new requirements.

The Board and its respective committees’ mandates are subject to an annual review to ensure that they continue to reflect the current processes, best practices and any new regulatory requirements. The last updates were initiated and approved by the Board in December 2014.

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

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

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

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



SHAREHOLDERS

The current shareholding structure of GIB is as follows:-

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

ORGANISATION – RULES AND ROLES

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

- There is an effective and appropriately constituted Board responsible for the stewardship of the Bank and the supervision of its business; it receives from management all information required to properly fulfil its duties and the duties of the committees that assist it, and it delegates to management the authority and responsibility for managing the day-to-day business of the Bank.

- There is an effective and appropriately organised management structure responsible for the day-to-day management of the Bank and the implementation of Board-approved strategy, policies and controls.
- There is a clear division of roles and responsibilities between the Board and management, and between the Chairman and the Chief Executive Officer (CEO).
- There are defined and documented mandates and responsibilities (as well as delegated authorities where applicable) for senior management.

The Bank's corporate governance structure and organisation chart is set out on page 47 of this Annual Report.

BOARD OF DIRECTORS

Under GIB's AoA the Board is comprised of up to ten members to be appointed or elected every three years. The AoA gives the right to each shareholder holding 10 per cent of the share capital to appoint one member on the Board. The shareholders exercising this right also have the right to terminate such appointment and replace the relevant directors. The appointment of directors is subject to prior approval from the CBB. In 2012, the shareholders re-appointed the directors for a new three year term.

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

At the year end, the Board comprised seven non-executive directors, including the Chairman and Vice-Chairman, who together bring a wide range of skills and experience to the Board. Their biographies are set out on page 48 of this Annual Report.

Corporate governance statement (continued)

INDEPENDENCE OF DIRECTORS

The independence or non-independence of the directors is subject to an annual review by the Board. As at 31st December 2014, two (2) directors of the Bank were classified as non-independent in accordance with the CBB regulations, and the other directors were classified as independent (see table on page 36).

BOARD RESPONSIBILITIES

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

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

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

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

Finally, the Board delegates to management the responsibility for the day-to-day management of the Bank in accordance with policies, guidelines and parameters set by the Board.

In preparation for Board and committees meetings, the directors receive, in a timely manner, regular reports and all other information required for such meetings, supplemented by any additional information specifically requested by the directors from time to time. The directors also receive monthly financial reports and other regular management reports that enable them to evaluate the Bank's and management's performance against agreed objectives. As prescribed in GIB's Articles of Association, the Board plans at least four meetings per year, with further meetings to occur at the discretion of the Board.

The Board did not consider any issues that were outside the ordinary course of business during 2014.

The details of Board membership and directors' attendance during 2014 are set out in the following table.

DIRECTORS' ATTENDANCE JANUARY – DECEMBER 2014

Board members	Board meetings	Executive Committee meetings	Audit Committee meetings	Nomination & Remuneration Committee meetings	Risk Policy Committee meetings	Corporate Governance Committee meetings	Executive / Non-executive	Independent / Non-independent
H.E. Jammaz bin Abdullah Al-Suhaimi, Chairman	6(6)	1(1)*					Non-executive	Independent
H.E. Dr. Hamad bin Sulaiman Al-Bazai, Vice Chairman	6(6)	1(1)			4(4)*		Non-executive	Non-independent
Professor Abdullah bin Hassan Alabdulgader	6(6)	1(1)	6(6)*			2(2)*	Non-executive	Independent
H.E. Sulaiman bin Abdullah Al-Hamdan	6(6)	1(1)		6(6)*			Non-executive	Independent
Mr. Abdulla bin Mohammed Al Zamil	6(6)			6(6)	4(4)	2(2)	Non-executive	Independent
Mr. Khaled bin Saleh Al-Mudaifer	6(6)		6(6)	5(6)		2(2)	Non-executive	Independent
Mr. Omar Hadir Al-Farisi	6(6)		6(6)		4(4)		Non-executive	Non-independent

* Committee Chairman

Figures in brackets indicate the maximum number of meetings during the year

Corporate governance statement (continued)

BOARD COMMITTEES

The committees of the Board of Directors derive their authorities and powers from the Board. Details of committees' memberships and attendance are listed in the tables below:-

BOARD COMMITTEES' MEMBERSHIPS

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

BOARD AND COMMITTEES MEETINGS DURING 2014

Type of meeting	Meeting dates
Board of Directors	1. 15 th February 2014
	2. 19 th March 2014
	3. 26 th April 2014
	4. 18 th July 2014
	5. 16 th October 2014
	6. 12 th December 2014
Executive Committee	1. 16 th October 2014
Audit Committee	1. 14 th February 2014
	2. 18 th April 2014
	3. 17 th July 2014
	4. 15 th October 2014
	5. 2 nd November 2014
	6. 12 th December 2014
Nomination & Remuneration Committee	1. 11 th January 2014
	2. 25 th February 2014
	3. 18 th March 2014
	4. 17 th April 2014
	5. 18 th July 2014
	6. 29 th September 2014
Risk Policy Committee	1. 15 th February 2014
	2. 17 th April 2014
	3. 17 th July 2014
	4. 15 th October 2014
Corporate Governance Committee	1. 14 th February 2014
	2. 11 th December 2014

EXECUTIVE COMMITTEE

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

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

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

Corporate governance statement (continued)

AUDIT COMMITTEE

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

- Assisting the Board in its oversight of (i) the integrity and reporting of the Bank's quarterly and annual financial statements, (ii) compliance with legal and regulatory requirements; (iii) the Bank's systems of internal controls; and (iv) the qualifications, independence and performance of the Bank's internal and external auditors.
- Overseeing performance of the Bank's internal audit function and independent audits.

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

RISK POLICY COMMITTEE

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

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

- Receives updates on operational risk management.
- Receives reports on changes to credit approvals or extension processes, credit risk measurement, market risk measurement and risk control measures.

NOMINATION & REMUNERATION COMMITTEE

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

Nomination matters:-

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

Remuneration matters:-

Reviewing and making recommendations to the Board in respect of:-

- The executive remuneration and incentive policy which includes the fixed and variable remuneration for approved persons, and material risk-takers.
- Policies relating to recruitment, retention, performance measurement and termination for the directors, the Chief Executive Officer and members of senior management.
- Approve, monitor and review the remuneration system to ensure the system operates as intended.
- Approve the remuneration amounts for each approved person and material risk-taker, as well as total variable remuneration to be distributed, taking account of total remuneration including salaries, fees, expenses, bonuses and other employee benefits.
- Review the stress testing and back testing results before approving the total variable remuneration to be distributed including salaries, fees, expenses, bonuses and other employee benefits.

Corporate governance statement (continued)

CORPORATE GOVERNANCE COMMITTEE

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

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

EVALUATION OF THE BOARD OF DIRECTORS

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

INDUCTION & THE CONTINUING EDUCATION OF DIRECTORS

In April 2014, the Board was provided a refresher session in the form of a workshop on corporate governance covering key local regulations and the latest development impacting the Bank and its board members. Furthermore, the Board and its committees regularly receive updates on key development in the regulatory and other areas that fall under their responsibilities (such as the update on the International Accounting Standards and the remuneration regulations issued by the CBB).

Also, in December 2014, the Board received an update in key development in the regulations in jurisdictions where the Bank has physical presence (Bahrain, Saudi Arabia and United Kingdom).

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

MANAGEMENT

The senior management team is responsible for the day-to-day management of the Bank entrusted to it by the Board. It is headed by the CEO, who is assisted by the Managing Director-Chief Financial Officer, the Managing Director-Chief Risk Officer, the Senior Managing Director-Chief Operating Officer, the Managing Director-Wholesale Banking Head, the Retail Banking Head, the Chief Investment and Treasury Officer, the Chief Information Officer and the Chief Human Resources Officer. The biographies of the key members of the senior management team are set out on page 50 of this Annual Report.

Six committees assist the CEO in the management of the Bank, which are:-

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

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

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

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

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

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

Corporate governance statement (continued)

REMUNERATION

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

During the year, the Bank has adopted the Sound Remuneration Practices issued by the CBB and has updated its variable remuneration framework. The Board has approved the revised policy framework and incentive components for submission to shareholders approval at the 2015 AGM. The key features of the remuneration framework have been summarized below.

Remuneration strategy

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

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

- fixed pay;
- benefits;
- annual performance bonus; and
- deferred bonus share plan.

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

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

In order to ensure alignment between what is paid to employees and the business strategy, GIB assess bank-wide, divisional and individual performance against annual and long-term financial and non-financial objectives summarised in line with the business planning and performance management process.

This takes into account adherence to the Bank's values, risk and compliance measures and above all acting with integrity. Altogether, performance is therefore judged not only on what is achieved over the short and long-term but also importantly on how it is achieved, as the latter contributes to the long-term sustainability of the business.

NRC role and focus

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

The aggregate remuneration paid to the NRC members during the year in the form of sitting fees amounted to US\$51,000 [2013: US\$36,000].

External consultants

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

Scope of application of the remuneration policy

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

Board remuneration

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

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

In 2014, the aggregate remuneration paid to Board members and key management personnel was US\$8.5 million [2013: US\$9.0 million] of which US\$2.5 million [2013: US\$2.4 million] was paid to the Board members.

Corporate governance statement (continued)

Variable remuneration for staff

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

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

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

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

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

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

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

Remuneration of control functions

The remuneration level of staff in the control and support functions allows the Bank to employ qualified and experienced personnel in these functions. The Bank ensures that the mix of fixed and variable remuneration for control and support function personnel is weighted in favour of fixed remuneration. The

variable remuneration of control functions is based on function-specific objectives and is not to be determined by the individual financial performance of the business area they monitor.

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

Variable compensation for business units

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

Risk assessment framework

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

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

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

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

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

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

Corporate governance statement (continued)

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

Risk adjustments

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

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

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

The NRC, with Board's approval, can rationalize and make the following discretionary decisions:-

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

Malus and Clawback framework

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

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

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

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

Components of variable remuneration

Variable remuneration has following main components:-

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

All deferred awards are subject to malus provisions. All share awards are released to the benefit of the employee after a six (6) month retention period from the date of vesting. The number of equity share awards is linked to the Bank's share price as per the rules of the Bank's Share Incentive Scheme. Any dividend on these shares is released to the employee along with the shares (i.e. after the retention period).

Corporate governance statement (continued)

Deferred remuneration

All employees from the grade of Senior Vice-President ("SVP") and higher shall be subject to deferral of variable remuneration as follows:-

Element of variable remuneration	Allocation of variable remuneration			Retention	Malus	Clawback
	CEO, MDs and 5 highest paid business line employees	SVP and higher	Deferral period			
Upfront cash	40%	50%	none	-	-	Yes
Upfront shares	-	10%	none	6 months	Yes	Yes
Deferred cash	10%	-	3 years*	-	Yes	Yes
Deferred share awards	50%	40%	3 years*	6 months	Yes	Yes

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

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

Details of remuneration

(a) Board of Directors

US\$ thousands	2014	2013
Sitting fees	343	377
Remuneration fees	1,191	1,179
Others*	936	825
	2,470	2,381

* Represents allowance to cover travelling and accommodation while attending Board and related committees meetings including fees paid to a member for providing advisory services to the Bank US\$360,000 (2013: US\$360,000).

Corporate governance statement (continued)

(b) Employee remuneration

US\$ thousands	Number of staff	2014									Total
		Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					
		Cash	Others	(Cash / shares)	(Cash / shares)	Upfront		Deferred			
						Cash	Shares	Cash	Shares	Others	
Approved persons											
- Business Lines	7	2,880	331	-	-	793	8	188	972	-	5,172
- Control & Support	9	2,740	297	-	-	407	55	33	384	-	3,916
Other material risk takers											
	8	1,617	227	-	-	188	38	-	150	-	2,220
Other staff	241	24,452	4,563	-	-	2,697	36	-	145	-	31,893
Overseas staff	665	46,764	8,908	-	-	8,105	-	-	-	-	63,777
	930	78,453	14,326	-	-	12,190	137	221	1,651	-	106,978

Other staff expenses reported in the consolidated statement of income that have not been included in the table above, amounting to US\$8.4 million, comprise indirect staff costs including training, recruitment expenses, life assurance contributions, and differences between accrued staff expenses and the amounts actually paid.

US\$ thousands	Number of staff	2013									Total
		Fixed remuneration		Sign on bonuses	Guaranteed bonuses	Variable remuneration					
		Cash	Others	(Cash / shares)	(Cash / shares)	Upfront		Deferred			
						Cash	Shares	Cash	Shares	Others	
Approved persons											
- Business Lines	8	3,136	364	-	-	2,117	-	-	-	-	5,617
- Control & Support	9	2,508	274	-	-	1,091	-	-	-	-	3,873
Other material risk takers											
	14	2,558	308	-	-	596	-	-	-	-	3,462
Other staff	258	30,458	5,472	-	-	3,585	-	-	-	-	39,515
Overseas staff	452	28,240	6,696	-	-	7,711	-	-	-	-	42,647
	741	66,900	13,114	-	-	15,100	-	-	-	-	95,114

Other staff expenses reported in the consolidated statement of income that have not been included in the table above, amounting to US\$6.2 million, comprise indirect staff costs including training, recruitment expenses, life assurance contributions, and differences between accrued staff expenses and the amounts actually paid.

(c) Severance pay

The severance payments during the year amounted to US\$410,117 [2013: US\$191,210] of which the highest paid to a single person amounted to US\$152,403 [2013: US\$125,798].

Corporate governance statement (continued)

CORPORATE COMMUNICATIONS

The Bank has in place a Corporate Communications Policy which ensures that the disclosures made by GIB are fair, transparent, comprehensive and timely, and reflect the character of the Bank and the nature, complexity and risks inherent in its business activities. Main communications channels include the Annual Report, corporate brochures, staff newsletters, and announcements in the appropriate media.

This transparency is also reflected in the Bank's website (www.gib.com) that provides substantial information on the Bank, including its profile and milestones; vision, mission, values, strategy and objectives; its financial statements; and its press releases.

CODE OF CONDUCT

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

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

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

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

DISCLOSURES

The Bank's website also provides access to GIB's Annual Reports, and all the information contained in these reports is therefore accessible globally. That information includes management discussion on the business activities of the Bank, as well as discussion and analysis of the financial statements and risk management. The financial information reflects the latest international accounting standards requirements, including the revised employee benefits standard issued under International Accounting Standard No. 19 as well as increased level of disclosure resulting from the adoption of International Financial Reporting Standard No. 13 – Fair Value Measurement.

The Board-approved Disclosure Policy is in accordance with the requirements of Basel 2 Pillar 3, in compliance with CBB rules. The objective of this Policy is to ensure transparency in the disclosure of the financial and risk profiles of the Bank to all interested parties.

POLICY ON CONNECTED COUNTERPARTIES

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

POLICY ON RELATED PARTY TRANSACTIONS

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

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

Corporate governance statement (continued)

MATERIAL TRANSACTIONS THAT REQUIRE BOARD APPROVAL

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

COMPLIANCE

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

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

ANTI-MONEY LAUNDERING

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

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

CORPORATE GOVERNANCE FRAMEWORK – AUDIT

The Internal Audit review of the Bank's Corporate Governance framework is conducted annually as a separate project since the introduction of the corporate governance rules in 2010. Accordingly, the latest audit was undertaken in May 2014. The purpose of the audit was to provide a level of assurance over the processes of corporate governance within the Bank. The scope of the audit included reviewing the existing policies, procedures and current practices followed by GIB in light of the CBB rules contained in the HC Module of the CBB Rulebook.

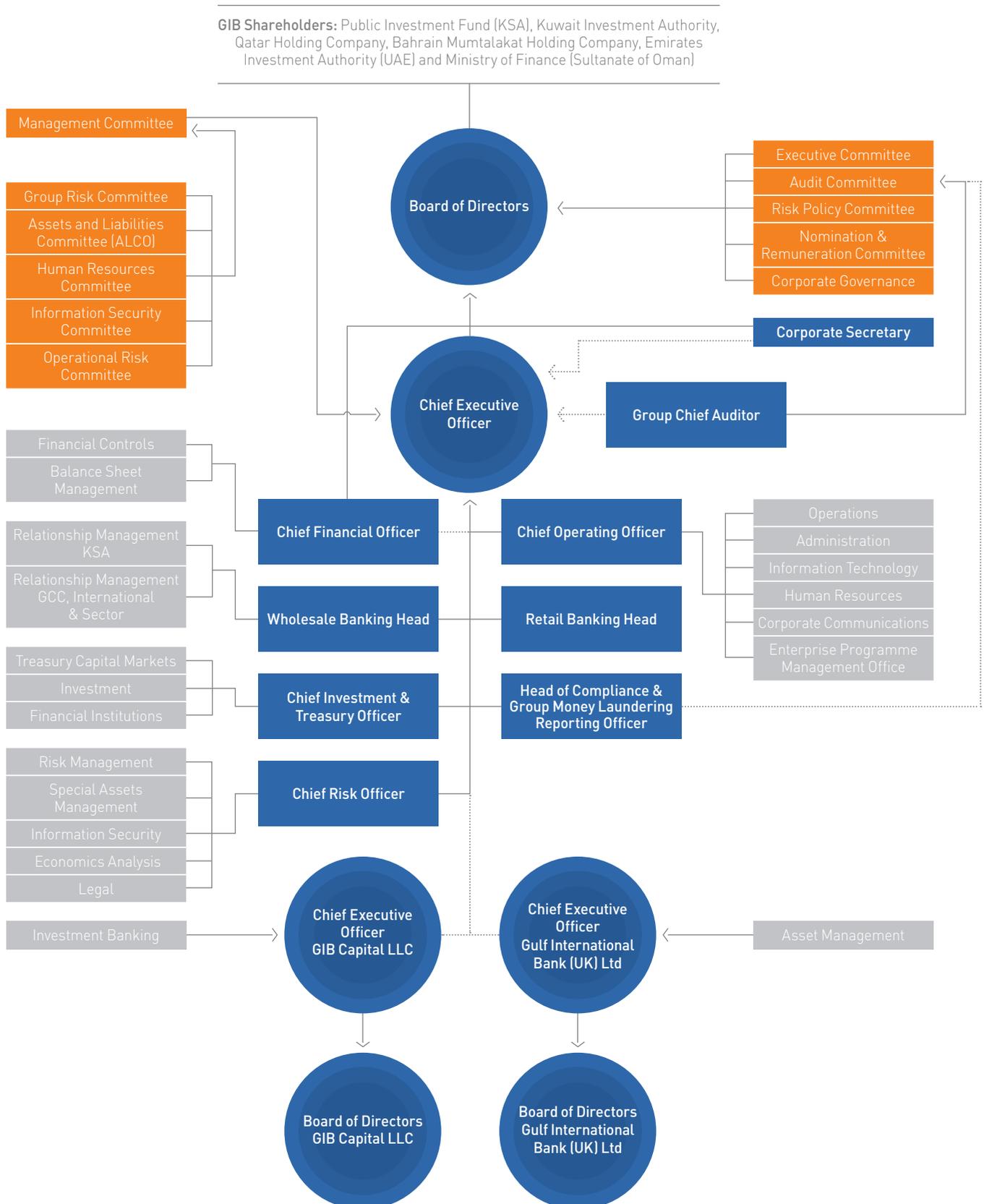
The overall conclusion of the audit was that the Corporate Governance framework of GIB appears to be operating effectively and is providing a sound framework to control the risks inherent in GIB's current business activities.

STATUS OF COMPLIANCE WITH THE CBB RULES (MODULE HC)

GIB is in compliance with the CBB rules on Corporate Governance outlined in Module HC of the CBB Rulebook, and instances of non-compliance in 2014 are explained as follows:-

- Module HC 7.2.2 requires all directors to attend and be available to answer questions from shareholders at any shareholder meeting. The Chairman of the Board of Directors did not attend the Annual General Meeting ("AGM") that was held on 19th March 2014. The Vice-Chairman of the Board chaired the AGM.
- Under Article 2 of GIB's Agreement of Establishment approved by Decree Law No. (30) for the year 1975 (as amended from time to time) (the "Agreement of Establishment"), GIB is subject to the Agreement of Establishment and its AoA (together the "GIB Constitutional Documents"), and in the event of any conflict between the GIB Constitutional Documents and the internal law of the Kingdom of Bahrain, the terms of the Constitutional Documents shall prevail. As a result, certain Corporate Governance requirements under HC-1, HC-4 and HC-5 that are in conflict with the AoA such as the nomination of Directors, the attendance requirements for Directors, the prohibition against proxies at Board Meetings and the Board of Directors total remuneration, have not been adopted.

Organisation and corporate governance chart



Biographies of the Board of Directors



H.E. Jammaz bin Abdullah Al-Suhaimi (1)
Chairman

H.E. Al-Suhaimi joined GIB as Chairman of the Board of Directors in 2008 and was re-elected in 2009 and in 2012 for three years. Prior to that, he served between 2004 and 2006 as Chairman and Chief Executive of the Saudi Arabia Capital Market Authority, the regulatory body for the capital market in the Kingdom of Saudi Arabia. During the period 1989-2004, he was Deputy Governor of the Saudi Arabian Monetary Agency. He initially joined SAMA as Director-General for Banking Control. He also served as Deputy Director General of the Saudi Industrial Development Fund from 1982 to 1984. In November 2009, he was appointed Vice Chairman and Member of the Board of Directors of the Saudi Arabian Investment Company (Sanabil Investments). He has also held Board memberships in many leading public and private organisations, including the Saudi Arabian General Investment Authority, the General Petroleum and Minerals Organisation, the National Company for Cooperative Insurance and the London-based Saudi International Bank (which merged with GIB in 1999). H.E. Al-Suhaimi holds a Bachelor's degree in Electrical Engineering from the University of Washington in Seattle, USA.



H.E. Dr. Hamad bin Sulaiman Al-Bazai (1) (3)
Vice Chairman

H.E. Dr. Al-Bazai was appointed to GIB's Board of Directors in 1999. He is currently the Vice Minister of Finance for the Kingdom of Saudi Arabia. Prior to that he served as Deputy Minister of Finance for Economic Affairs. Dr. Al-Bazai is a Board Member of the Southern Region Cement Company and Tatweer Education Holding Company. He holds a BA in Administrative Sciences from King Saud University in Saudi Arabia, and an MS and a PhD in Economics from Colorado State University, USA.



Professor Abdullah bin Hassan Alabdulgader (1) (2) (5)

Professor Alabdulgader joined GIB's Board of Directors in 2009. He is serving on a number of boards of directors and audit committees of large companies, including the Saudi Arabian Investment Company (Sanabil), the Saudi Company for Development and Technology Investment (Taqnia), Riyad Bank, and the Saudi Arabian Mining Company (Ma'aden). He chairs the Advisory Committee of the Saudi Arabia Capital Market Authority (CMA) and the Professional Quality Monitoring Committee at the Saudi Organization of Certified Public Accountants (SOCPA). He was Professor of Business Administration at King Fahd University of Petroleum and Minerals and served as Commissioner at the Saudi Arabia Capital Market Authority (CMA). During his tenure, he led corporate governance code development. As a founding executive director of the GCC Board Directors Institute, he continued promoting corporate governance in the region. Professor Alabdulgader holds a BSc degree in Business Administration and MBA from King Fahd University of Petroleum and Minerals. He obtained his Doctoral degree in Business Administration from the University of Colorado-Boulder, USA.



H.E. Sulaiman bin Abdullah Al-Hamdan (1) (4)

Recently, H.E. Al-Hamdan was appointed President of General Authority of Civil Aviation in KSA. H.E. Al-Hamdan joined GIB's Board of Directors in 2009. He was the Group Chief Executive Office at National Air Services (NAS Holding) in Saudi Arabia since November 2008, and Board Member of NAS Holding. He was a Member of the Advisory Commission of the Supreme Economic Council. Prior to that he held various positions at the Saudi British Bank, including that of Deputy Managing Director and General Manager Personal Banking. He worked at the Saudi Fund for Development between 1979-1985. He was a Member of the Board of Trustees at Al Yamamah University, and he was a Member of the Advisory Committee to Industrial Management College at KFUPM and at Prince Sultan University. H.E. Al-Hamdan had previously served as Board Member and Chairman of Saudi Hollandi Capital and Board Member of Middle East Specialized Cables Company (MESCC) and Al Ahlia Cooperative Insurance Company. H.E. Al-Hamdan holds a Bachelor's degree in Administrative Science from King Saud University (1979), and an MBA from the University of New Haven Connecticut in USA (1985).

Biographies of the Board of Directors (continued)



Mr. Abdulla bin Mohammed Al Zamil (3) (4) (5)

Mr. Al Zamil joined GIB's Board of Directors in 2009. He is the Chief Executive Officer and Board Member of Zamil Industrial Investment Company "Joint Stock Company." He was the Company's Chief Operating Officer from 2004-2009. Prior to that he was Senior Vice President at Zamil Air Conditioners. He started his career at Zamil Air Conditioners in 1987 as an industrial engineer. Mr. Al Zamil is a Board member of many companies including Gulf Insulation Group (GIG) and Ranco-Zamil Concrete Industries. He is also Chairman of the Board of GIB Capital, Chairman of the Board of Saudi Global Ports (joint venture between the KSA Public Investment Fund and Singapore Ports Authority) and Board Member of GIB UK, in addition to his Board Membership of Human Resources Development Fund (Government Entity) and Board member in Viva Bahrain (wholly owned by Saudi Telecom Co.); in addition to Board Membership in the following charity and community services (non-profit organisations): Saudi Food Bank (Etaam), Endeavor - Saudi Arabia & Dhahran Ahliyya School. Mr. Al Zamil holds a Bachelor's degree in Industrial Engineering from the University of Washington, Seattle, USA, and an MBA with concentration in Finance from King Fahd University of Petroleum and Minerals (KFUPM), Dhahran, Saudi Arabia.



Mr. Khaled bin Saleh Al-Mudaifer (2) (4) (5)

Mr. Al-Mudaifer joined GIB's Board of Directors in 2009. He is the President & CEO of Ma'aden. He joined Ma'aden in March 2006 as Vice President for Industrial Affairs. In 2007, he became Vice President for Phosphate and New Business Development. Prior to that, he was the Managing Director of Qassim Cement Company (1993-2006). Between 1987 and 1993, he held various positions in Eastern Petrochemical Company (Sharq - a SABIC affiliate) last of which as Vice President-Finance. Currently, he is Board and Executive Committee Member of Ma'aden. Mr. Al-Mudaifer in the past was a Board Member of Qassim Cement Company and Saudi Arabian Railway Company. Mr. Al-Mudaifer holds a BSc in Engineering (1984) and MBA (1987) from King Fahd University of Petroleum and Minerals (KFUPM), Dhahran, Saudi Arabia.



Mr. Omar Hadir Al-Farisi (2) (3)

Mr. Al-Farisi joined GIB's Board of Directors in November 2012. He is Managing Member of Diyala Advisors, LLC, in New York (since 2003) and an advisor to the Public Investment Fund of Saudi Arabia. Previously, Mr. Al-Farisi was an investment banker at Credit Suisse First Boston in New York (2000-2003) where he focused on energy sector financings, mergers and acquisitions and related transactions. Prior to his career in banking, Mr. Al-Farisi was an attorney at the law firm of White & Case in New York (1994-2000) where he was a member of its Corporate & Financial Services Department. Mr. Al-Farisi earned his BA in Economics from the University of Notre Dame, and a JD from Columbia University School of Law.

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



Biographies of senior management

Dr. Yahya A. Alyahya

Chief Executive Officer – Gulf International Bank
Chairman – Gulf International Bank (UK) Limited

Dr. Yahya Alyahya’s diverse international professional experience spans 39 years. He was appointed Chief Executive Officer of Gulf International Bank (GIB) in January 2009. Prior to this, he served on the Board of the World Bank Group as Executive Director representing Saudi Arabia from 1999 to 2006. During this period he acted as Dean of Executive Directors; Chairman of the Board Steering Committee and the Personnel Committee; Vice Chairman of the Audit Committee; and Member of the Budget Committee and Governance Committee. Previous positions include Advisor to the Governor, Saudi Arabian Monetary Agency (1999); General Manager of E.A. Juffali & Bros., Riyadh (1994-1999); Founder and Director General, Institute of Banking, Riyadh (1989-1994); Professor of Industrial and Systems Engineering at King Saud University, Riyadh (1986-1989) and the University of Michigan, USA (1983-1986); and Lecturer on Matching Problems and Algorithms at the Indian Statistical Institute, Bangalore, India (1982). He started his career in 1975 as a Project Analyst at the Saudi Industrial Development Fund, Riyadh.

Dr. Alyahya is currently Chairman of Gulf International Bank (UK) Limited; Shuaibah Water and Electricity Company (the first IWPP in Saudi Arabia); and Shuaibah Expansion Project Company. In 2013, he was appointed as a Board Member of the Institute of International Finance (IIF), and in 2014, Co-Chairman of Emerging Markets Advisory Council (EMAC) at the Institute of International Finance (IIF); and a Member of the Conciliation and Arbitration Panels of the International Center for Settlement of Investment Disputes. His previous board and board committee memberships include the Group of Twenty (G20) High Level Panel on Infrastructure Investment; Sanabil Strategy Steering Group; Oger Telecom; Saudi Re; Gulf Investment Corporation; National Commercial Bank; Gulf International Bank; Saudi Agricultural Bank; the Audit Committee of Al Bank Al Saudi Al Fransi; and the Saudi Engineering Society.

Dr. Alyahya holds a PhD in Industrial and Systems Engineering from the University of Michigan, USA; and is a Graduate of King Fahd University of Petroleum and Minerals, Dhahran (KFUPM).

Stephen D. Williams

Managing Director – Chief Financial Officer

Member of Management Committee, Assets and Liabilities Committee, Group Risk Committee, Operational Risk Committee, and Information Security Committee

Stephen Williams has 30 years’ international experience in banking, accountancy and audit. Joining GIB in 1987, he was appointed Group Financial Controller in 2000, and Chief Financial Officer in 2008. He is currently responsible for Group-wide statutory, regulatory and management reporting; financial and balance sheet planning, and capital management. He also has responsibility for the Bank’s Basel 3 implementation project. Prior to joining GIB, he worked for KPMG in London and the Middle East.

A certified Chartered Accountant and Member of the Institute of Chartered Accountants in England and Wales (ICAEW), Stephen Williams holds a BSc Degree in Economics from Cardiff University, UK. He is a Member of the Working Groups on Capital Adequacy and Working Liquidity at the Institute of International Finance.

Masood Zafar

Managing Director – Chief Risk Officer

Member of Management Committee, Assets and Liabilities Committee, Group Risk Committee, Operational Risk Committee, and Information Security Committee

Masood Zafar has 35 years’ international experience in banking, accountancy, audit and risk management. Joining GIB in 1982 in the Internal Audit department, he was subsequently appointed Chief Internal Auditor in 1987, Chief Credit Officer in 2004, and Chief Risk Officer in 2012. Prior to joining GIB, Mr. Zafar worked at Ernst & Young in London, and KPMG in Bahrain.

Masood Zafar is a Fellow of the Institute of Chartered Accountants in England and Wales.



Biographies of senior management (continued)

Abdullah Al-Zahrani

Executive Vice President – Chief Investment & Treasury Officer

Member of Management Committee, Assets and Liabilities Committee, Operational Risk Committee, and Information Security Committee

Abdullah Al-Zahrani has 22 years' regional experience in banking, investments and treasury. He joined GIB in his current position in 2011 with responsibility for Treasury, Investments Department and Financial Institutions Group. Prior to joining GIB, he was Senior Vice President and Assistant Treasurer at Riyad Bank for six years. His previous experience includes Assistant General Manager and Head of Portfolio Management at Arab National Bank; and Senior Trader at National Commercial Bank. He started his career in 1993 as a Fixed Income Dealer in the Investment Department at the Saudi Arabian Monetary Agency.

Abdullah Al-Zahrani holds a BSc in Industrial Management from King Fahd University of Petroleum and Minerals, Saudi Arabia; and is a Graduate of INSEAD's International Executive Programme.

Stewart Macphail

Chief Operating Officer

Member of Management Committee and Operational Risk Committee

Stewart Macphail joined GIB in his current position in December 2014. As Chief Operating Officer, Stewart is responsible for Group Operations, Information Technology, Human Resources, Administration Services, Corporate Communications and the Enterprise Programme Management Office.

Stewart has over 26 years' international business experience in both financial services and other business sectors from retail to construction. Over the past seven years Stewart has held a range of senior executive roles and Board Director positions across a diverse range of business in the MENA region; from large family groups, public companies and private equity held businesses. In these positions Stewart has operated at a strategic management level; developing restructuring strategies and translating them into clear operational implementation plans. Prior to moving to the Middle East, Stewart worked for GE Capital in Europe for over 12 years and was latterly the CEO of GE Capital's Card Services business in the UK.

Stewart Macphail holds a BA Honours degree in Business and Law from Lancaster University, UK.

Sakhr Bin Abdulrahman Almulhem

Executive Vice President – Head of Retail Banking

Member of Management Committee, Assets and Liabilities Committee, Operational Risk Committee, and Information Security Committee

Sakhr Bin Abdulrahman Almulhem has over 19 years' experience in the banking industry covering North and Central America, the UK and the Middle East. He joined GIB in 2011 as Senior Vice President – Head of Proposition in Retail Banking, and was appointed to his present position in 2013. Prior to joining GIB, he was Senior Vice President – Divisional Head of Retail Customer Management at National Commercial Bank (NCB), Saudi Arabia. His previous positions with NCB included Vice President – Regional Manager, and Vice President – Head of Sales Development. He started his career with SABB where he held various positions in the areas of Relationship Management, Branch Management, Quality Management and Consumer Finance.

Sakhr Bin Abdulrahman Almulhem holds an MBA and a BBA in Marketing from Washington University, USA.

Mark Watts

Managing Director – Chief Executive Officer
Gulf International Bank (UK) Limited

Mark Watts has 27 years' experience in asset management gained in the UK, USA and UAE, covering equities, fixed income, alternatives, structured products, emerging markets, currencies, derivatives, and real estate. He was appointed to his current position in 2014.

Prior to joining GIB UK, Mark Watts spent four years with the National Bank of Abu Dhabi, where his final position was Managing Director and Chief Investment Officer of the Asset Management Group. Previously, he was Head of Asset Management at Qatar Islamic Bank-owned European Finance House based in London; and Head of Global Fixed Income at Aviva Investors. Before this, he spent over 17 years at Baring Asset Management, a leading UK-based investment management firm, working in the UK and the US.

Mark Watts is a CFA Charter Holder, and a Fellow of the Chartered Institute for Securities & Investment (CISI). He holds Diplomas from the CISI and the International Security Managers Association (ISMA), together with the Islamic Finance Qualification (IFQ).

Consolidated Financial Statements

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Independent auditors' report to the shareholders

Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of Gulf International Bank B.S.C. (the "Bank") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at 31 December 2014, the consolidated statements of income, comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Responsibility of the board of directors for the consolidated financial statements

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

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2014, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards.

Report on other regulatory requirements

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

- a) the Bank has maintained proper accounting records and the consolidated financial statements are in agreement therewith;
- b) the financial information contained in the chairman's statement is consistent with the consolidated financial statements;
- c) we are not aware of any violations during the year of the Bahrain Commercial Companies Law, the Central Bank of Bahrain and Financial Institutions Law, the CBB Rule Book (Volume 1, applicable provisions of Volume 6 and CBB directives) or the terms of the Bank's memorandum and articles of association that would have had a material adverse effect on the business of the Bank or on its financial position; and
- d) satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG



KPMG Fakhro

Partner Registration No. 83

13 February 2015

Consolidated statement of financial position

	Note	31.12.14 US\$ millions	31.12.13 US\$ millions
ASSETS			
Cash and other liquid assets	5	2,472.6	1,659.4
Securities purchased under agreements to resell	6	1,305.2	1,742.7
Placements	7	5,180.5	5,264.6
Trading securities	8	72.7	50.9
Investment securities	9	3,944.5	3,725.8
Loans and advances	10	7,931.5	8,317.2
Other assets	11	393.2	396.3
Total assets		21,300.2	21,156.9
LIABILITIES			
Deposits from banks	13	1,240.1	1,446.3
Deposits from customers	13	12,897.8	13,451.3
Securities sold under agreements to repurchase	14	618.0	785.2
Other liabilities	15	342.9	399.4
Senior term financing	16	3,372.9	2,332.9
Subordinated term financing	17	477.8	477.8
Total liabilities		18,949.5	18,892.9
EQUITY			
Share capital	18	2,500.0	2,500.0
Reserves	19	392.0	374.3
Retained earnings		(541.3)	(610.3)
Total equity		2,350.7	2,264.0
Total liabilities & equity		21,300.2	21,156.9

The consolidated financial statements were approved by the Board of Directors on 13th February 2015 and signed on its behalf by:-



Jammaz bin Abdullah Al-Suhaimi
Chairman



Abdullah bin Hassan Alabdulgader
Chairman of the Board Audit Committee



Yahya bin Abdullah Alyahya
Chief Executive Officer

The notes on pages 60 to 107 form part of these consolidated financial statements.

Consolidated statement of income

	<i>Note</i>	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Interest income	21	308.9	305.3
Interest expense	21	150.9	142.2
Net interest income		158.0	163.1
Fee and commission income	22	62.9	62.0
Foreign exchange income	23	19.4	17.4
Trading income	24	2.4	9.3
Other income	25	14.9	26.5
Total income		257.6	278.3
Staff expenses		115.4	101.3
Premises expenses		15.7	13.9
Other operating expenses		33.8	36.4
Total operating expenses		164.9	151.6
Net income before provisions and tax		92.7	126.7
Provision release for investment securities	9	4.5	-
Provision charge for loans and advances	10	(10.3)	(4.2)
Net income before tax		86.9	122.5
Taxation charge on overseas activities		(1.3)	(1.0)
Net income		85.6	121.5
<i>Earnings per share</i>	38	US\$0.03	US\$0.05



Jammaz bin Abdullah Al-Suhaimi
Chairman



Abdullah bin Hassan Alabdulgader
Chairman of the Board Audit Committee



Yahya bin Abdullah Alyahya
Chief Executive Officer

The notes on pages 60 to 107 form part of these consolidated financial statements.

Consolidated statement of comprehensive income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Net income	85.6	121.5
Other comprehensive income:-		
Items that may subsequently be reclassified to consolidated statement of income:-		
Cash flow hedges:-		
- net changes in fair value	(0.2)	-
- net amount transferred to consolidated statement of income	(0.1)	(1.4)
	(0.3)	(1.4)
Items that will not be reclassified to consolidated statement of income:-		
Net changes in fair value of equity investments classified as fair value through other comprehensive income (FVTOCI)	7.0	31.1
Remeasurement of defined benefit pension fund	(5.6)	5.1
	1.4	36.2
Total other comprehensive income	1.1	34.8
Total comprehensive income	86.7	156.3

The notes on pages 60 to 107 form part of these consolidated financial statements.

Consolidated statement of changes in equity

	Share capital US\$ millions	Reserves US\$ millions	Retained earnings US\$ millions	Total US\$ millions
At 1st January 2014	2,500.0	374.3	(610.3)	2,264.0
Net income for the year	-	-	85.6	85.6
Other comprehensive income for the year	-	2.9	(1.8)	1.1
Total comprehensive income for the year	-	2.9	83.8	86.7
Transfer from retained earnings	-	14.8	(14.8)	-
At 31st December 2014	2,500.0	392.0	(541.3)	2,350.7
At 1st January 2013	2,500.0	328.2	(720.5)	2,107.7
Net income for the year	-	-	121.5	121.5
Other comprehensive income for the year	-	26.3	8.5	34.8
Total comprehensive income for the year	-	26.3	130.0	156.3
Transfer from retained earnings	-	19.8	(19.8)	-
At 31st December 2013	2,500.0	374.3	(610.3)	2,264.0

The notes on pages 60 to 107 form part of these consolidated financial statements.

Consolidated statement of cash flows

	Note	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
OPERATING ACTIVITIES			
Net income		85.6	121.5
Adjustments to reconcile net income to net cash inflow from operating activities:-			
Provisions for investment securities		(4.5)	-
Provisions for loans and advances		10.3	4.2
Realised profits on debt investment securities		(1.4)	(1.1)
Amortisation of investment securities		13.8	19.1
Amortisation of senior term financing		0.2	0.2
Net decrease / (increase) in statutory deposits with central banks		10.6	(66.9)
Net decrease / (increase) in securities purchased under agreements to resell		437.5	(731.9)
Net decrease / (increase) in placements		84.1	(784.9)
Net (increase) / decrease in trading securities		(21.8)	49.6
Net decrease / (increase) in loans and advances		375.4	(1,211.1)
(Increase) / decrease in accrued interest receivable		(3.6)	6.2
Increase in accrued interest payable		8.3	1.7
Net increase in other net assets		(54.7)	(25.7)
Net decrease in deposits from banks		(206.2)	(776.1)
Net (decrease) / increase in deposits from customers		(553.5)	3,979.4
Net cash inflow from operating activities		180.1	584.2
INVESTING ACTIVITIES			
Purchase of investment securities		(855.9)	(804.3)
Sale and maturity of investment securities		627.0	617.7
Net cash outflow from investing activities		(228.9)	(186.6)
FINANCING ACTIVITIES			
Net (decrease) / increase in securities sold under agreements to repurchase		(167.2)	187.5
Net increase / (decrease) in senior term financing		1,039.8	(100.0)
Net cash inflow from financing activities		872.6	87.5
Increase in cash and cash equivalents		823.8	485.1
Cash and cash equivalents at 1st January		1,515.8	1,030.7
Cash and cash equivalents at 31st December	5	2,339.6	1,515.8

The notes on pages 60 to 107 form part of these consolidated financial statements.

Notes to the consolidated financial statements

For the year ended 31st December 2014

1. Incorporation and registration

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

The Bank and its subsidiaries (the Group), is principally engaged in the provision of wholesale commercial, asset management and investment banking services. 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 930.

2. Accounting policies

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

2.1 Basis of preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and in conformity with the Bahrain Commercial Companies Law and the Central Bank of Bahrain and Financial Institutions Law. The consolidated financial statements have been prepared under the historical cost convention as modified by the revaluation of trading securities, equity investment securities, and derivative financial instruments as explained in more detail in the following accounting policies. Recognised assets and liabilities that are hedged by derivative financial instruments are also stated at fair value in respect of the risk that is being hedged. The accounting policies have been consistently applied by the Bank and its subsidiaries and are consistent with those of the previous year, except for the adoption of applicable new accounting standards with effect from 1st January 2014 as referred to below.

IAS 32 – Financial Instruments: Presentation

The amendments to IAS 32 clarify the requirements relating to the offset of financial assets and financial liabilities. The amendments have been applied retrospectively and have not had a significant impact on the Group's 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, which the Bank controls. The Bank controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The subsidiary's accounts are derecognised from the consolidated financial statements from the point when the control ceases. All intercompany balances and transactions, including unrealised gains and losses on transactions between Group companies, have been eliminated.

2.3 Foreign currencies

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.4 Financial assets and liabilities

Financial assets and liabilities comprise all assets and liabilities reflected in the statement of financial position, although excluding investments in subsidiaries, associated companies and joint ventures, employee benefit plans, property and equipment, deferred taxation and taxation payable.

a) Initial recognition and measurement

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

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

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

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

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

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

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

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

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

b) Subsequent measurement

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

Financial assets at amortised cost

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.4 Financial assets and liabilities (continued)

b) Subsequent measurement (continued)

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

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

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

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

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

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

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

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

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

Financial liabilities at amortised cost

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

Financial liabilities at fair value through the profit or loss

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

c) Derecognition of financial assets and liabilities

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.5 Impairment of financial assets

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

Provisions for impairment are determined based on the difference between the net carrying amount and the recoverable amount of the financial asset. The recoverable amount is measured as the present value of expected future cash flows, including amounts recoverable from guarantees and collateral, discounted based on the interest rate at the inception of the credit facility or, for debt instruments, at the current market rate of interest for a similar financial asset.

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

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

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

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

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

2.6 Offsetting financial assets and liabilities

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.7 Revenue recognition

a) Interest income and interest expense

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

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

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

b) Fees and commissions

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

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

c) Trading and foreign exchange income

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

d) Dividend income

Dividend income is recognised as follows:-

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

2.8 Securities financing arrangements

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.9 Premises and equipment

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

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

2.10 Other provisions

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

2.11 Derivative financial instruments and hedge accounting

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

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

In the consolidated statement of financial position, derivative financial instruments with positive fair values (unrealised gains) are included in other assets and derivative financial instruments with negative fair values (unrealised losses) are included in other liabilities.

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

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

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.11 Derivative financial instruments and hedge accounting (continued)

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

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

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

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

Some hybrid instruments contain both a derivative and non-derivative component. In such cases, the derivative is categorised as an embedded derivative. If the host contract is accounted for under IFRS 9 then the hybrid financial instrument is holistically assessed as to whether it should be measured at amortised cost or as fair value. If the host contract is not accounted for under IFRS 9 and the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract, and the overall contract itself is not carried at fair value, the embedded derivative is bifurcated and measured at fair value. If it is not practically possible to bifurcate the embedded derivative, the entire hybrid instrument is categorised as a financial asset at FVTPL and measured at fair value. Changes in fair value are included in trading income.

2.12 Financial guarantees

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

Financial guarantees are initially recognised at fair value on the date the guarantee is issued. The guarantee liability is subsequently measured at the higher of the initial measurement, less amortisation to recognise the fee income earned over the period, or the present value of any expected financial obligation arising as a result of an anticipated non-recoverable payment under a guarantee. Any increase in a liability relating to guarantees is recognised in the consolidated statement of income. In the consolidated statement of financial position, financial guarantees are included in other liabilities.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.13 Post retirement benefits

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

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

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

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

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

2.14 Taxation

a) Current tax

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

b) Deferred tax

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

2.15 Cash and cash equivalents

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

2. Accounting policies (continued)

2.16 Segment reporting

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

2.17 Fiduciary activities

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

2.18 Dividends

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

2.19 Shariah compliant banking

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

2.20 Comparatives

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

2.21 Future accounting developments

The International Accounting Standards Board (IASB) have issued a number of new standards, amendments to standards, and interpretations that are not yet effective and have not been applied in the preparation of the consolidated financial statements for the year ended 31st December 2014. The relevant new standards, amendments to standards, and interpretations, are as follows:-

- IAS 19 - Employee Benefits:-

Further amendments to the treatment of defined benefit plans within IAS19 have been issued which clarify how an entity should account for contributions made by employees. The Group is assessing the potential impact on its consolidated financial statements resulting from the application.

- IFRS 9 (2014) – Financial Instruments:-

IFRS 9 (2014) was issued as a complete standard including the requirements previously issued and adopted, and additional amendments to introduce a new expected loss impairment model, and limited changes to the classification and measurement requirements of financial assets. The Group is currently evaluating the potential impact of this standard and determining a date of initial application.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

3. Accounting estimates and assumptions

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

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

3.1 Provisions for impairment

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

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

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

3.2 Fair value of financial assets and liabilities

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

3.3 Retirement benefit obligations

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

3.4 Determination of control over investees

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

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

The principal investment funds are set out in note 35.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

4. Classification of assets and liabilities

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

	Financial assets at amortised cost US\$ millions	Financial assets & liabilities at FVTPL US\$ millions	Financial assets at FVTOCI US\$ millions	Financial liabilities at amortised cost US\$ millions	Non- financial assets & liabilities US\$ millions	Total US\$ millions
At 31st December 2014						
Cash and other liquid assets	2,472.6	-	-	-	-	2,472.6
Securities purchased under agreements to resell	1,305.2	-	-	-	-	1,305.2
Placements	5,180.5	-	-	-	-	5,180.5
Trading securities	-	72.7	-	-	-	72.7
Investment securities	3,636.9	-	307.6	-	-	3,944.5
Loans and advances	7,931.5	-	-	-	-	7,931.5
Other assets	132.7	130.0	-	-	130.5	393.2
Total assets	20,659.4	202.7	307.6	-	130.5	21,300.2
Deposits from banks	-	-	-	1,240.1	-	1,240.1
Deposits from customers	-	-	-	12,897.8	-	12,897.8
Securities sold under agreements to repurchase	-	-	-	618.0	-	618.0
Other liabilities	-	131.0	-	150.0	61.9	342.9
Senior term financing	-	-	-	3,372.9	-	3,372.9
Subordinated term financing	-	-	-	477.8	-	477.8
Equity	-	-	-	-	2,350.7	2,350.7
Total liabilities & equity	-	131.0	-	18,756.6	2,412.6	21,300.2
At 31st December 2013						
Cash and other liquid assets	1,659.4	-	-	-	-	1,659.4
Securities purchased under agreements to resell	1,742.7	-	-	-	-	1,742.7
Placements	5,264.6	-	-	-	-	5,264.6
Trading securities	-	50.9	-	-	-	50.9
Investment securities	3,417.4	-	308.4	-	-	3,725.8
Loans and advances	8,317.2	-	-	-	-	8,317.2
Other assets	132.9	174.9	-	-	88.5	396.3
Total assets	20,534.2	225.8	308.4	-	88.5	21,156.9
Deposits from banks	-	-	-	1,446.3	-	1,446.3
Deposits from customers	-	-	-	13,451.3	-	13,451.3
Securities sold under agreements to repurchase	-	-	-	785.2	-	785.2
Other liabilities	-	192.4	-	142.9	64.1	399.4
Senior term financing	-	-	-	2,332.9	-	2,332.9
Subordinated term financing	-	-	-	477.8	-	477.8
Equity	-	-	-	-	2,264.0	2,264.0
Total liabilities & equity	-	192.4	-	18,636.4	2,328.1	21,156.9

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

The fair value analysis of derivative financial instruments is set out in note 31.4.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

5. Cash and other liquid assets

	31.12.14 US\$ millions	31.12.13 US\$ millions
Cash and balances with central banks	1,519.4	1.1
Cash and balances with banks	494.5	212.7
Certificates of deposit	51.0	51.0
Government bills	274.7	1,251.0
Cash and cash equivalents	2,339.6	1,515.8
Statutory deposits with central banks	133.0	143.6
Cash and other liquid assets	2,472.6	1,659.4

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

The increase in cash and balances with central banks and the decrease in government bills at 31st December 2014 was principally attributable to the deposit of liquid funds with central banks rather than investment in government bills.

6. Securities purchased under agreements to resell

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

7. Placements

Placements at 31st December 2014 included placements with central banks amounting to US\$1,511.0 million (2013: US\$891.4 million). The placements with central banks represented the placement of surplus liquid funds.

8. Trading securities

	31.12.14 US\$ millions	31.12.13 US\$ millions
Managed funds	60.6	50.9
Equity securities	12.1	-
	72.7	50.9

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

Managed funds comprised funds placed for investment with specialist managers.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

9. Investment securities

9.1 Composition

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

	US\$ millions	31.12.14 %	US\$ millions	31.12.13 %
AAA to A- / Aaa to A3	3,298.3	90.7	3,048.9	89.2
BBB+ to BBB- / Baa1 to Baa3	338.6	9.3	368.5	10.8
Total debt securities	3,636.9	100.0	3,417.4	100.0
Equity investments	307.6		308.4	
	3,944.5		3,725.8	

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

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

9.2 Provisions for impairment

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

	2014 US\$ millions	2013 US\$ millions
At 1 st January	7.7	7.7
Release for the year	(4.5)	-
At 31st December	3.2	7.7

At 31st December 2014, the provisions for the impairment of investment securities entirely comprised non-specific provisions for debt investment securities determined on a collective basis.

The provision release during the year ended 31st December 2014 arose on an adjustment to the historical loss estimate to reflect the effects of current conditions in relation to the investment-grade rated debt securities. The probabilities of default applied in the calculation of the collective provisions for impairment at 31st December 2014 nevertheless continued to reflect stressed probabilities of default and exceeded prevailing default levels.

10. Loans and advances

10.1 Composition

	31.12.14 US\$ millions	31.12.13 US\$ millions
Gross loans and advances	8,532.6	8,908.5
Provisions for impairment	(601.1)	(591.3)
Net loans and advances	7,931.5	8,317.2

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

10. Loans and advances (continued)

10.2 Industrial classification

	31.12.14 US\$ millions	31.12.13 US\$ millions
Energy, oil and petrochemical	2,042.2	2,334.3
Trading and services	1,739.6	1,791.0
Financial	1,395.8	1,333.9
Transportation	1,068.8	1,048.4
Manufacturing	944.5	919.5
Construction	714.2	686.1
Communication	267.9	299.9
Real estate	143.3	275.1
Government	-	8.5
Other	216.3	211.8
	8,532.6	8,908.5
Provisions for impairment	(601.1)	(591.3)
	7,931.5	8,317.2

Gross loans at 31st December 2014 included Shariah-compliant transactions amounting to US\$2,190.1 million (2013: US\$2,407.0 million).

10.3 Provisions for impairment

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

	Specific US\$ millions	Non-specific US\$ millions	2014 Total US\$ millions	Specific US\$ millions	Non-specific US\$ millions	2013 Total US\$ millions
At 1 st January	423.3	168.0	591.3	436.7	189.0	625.7
Exchange rate movements	(0.5)	-	(0.5)	0.3	-	0.3
Amounts utilised	-	-	-	(38.9)	-	(38.9)
Amounts reallocated	20.0	(20.0)	-	21.0	(21.0)	-
Charge for the year	10.3	-	10.3	4.2	-	4.2
At 31st December	453.1	148.0	601.1	423.3	168.0	591.3

The level of non-specific loan provisions reflect the application of stressed probabilities of default in the calculation of provisions for impairment measured on a collective basis. Stressed probabilities of default are anticipated to result from the impact of the global recession on the regional economic environment.

Non-specific provisions at 31st December 2014 represented 1.8 per cent of non-specifically provisioned loans (2013: 2.0 per cent).

The gross amount of specifically provisioned loans at 31st December 2014 was US\$462.5 million (2013: US\$453.4 million). Total specific provisions at 31st December 2014 represented 98.0 per cent of loans against which a specific provision had been made (2013: 93.4 per cent).

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

10. Loans and advances (continued)

10.3 Provisions for impairment (continued)

Amounts utilised during the year ended 31st December 2013 represented provisions utilised on the settlement or sale of the related loans. No incremental losses arose on the settlement or sale of the loans.

Provision releases during the years ended 31st December 2014 and 31st December 2013 arose on the repayment of the related loans.

10.4 Past due loans

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

	Gross US\$ millions	31.12.14 Carrying Amount US\$ millions	Gross US\$ millions	31.12.13 Carrying Amount US\$ millions
Corporates	335.1	9.4	336.4	49.7
Financial institutions	134.1	6.7	139.5	11.7
	469.2	16.1	475.9	61.4

Corporates include loans extended for investment purposes.

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

	Past due but not impaired US\$ millions	31.12.14 Past due and impaired US\$ millions	Past due but not impaired US\$ millions	31.12.13 Past due and impaired US\$ millions
Less than 1 year	-	66.7	4.2	54.4
Years 2 to 5	6.7	395.8	62.7	354.6
	6.7	462.5	66.9	409.0

At 31st December 2014, interest-in-suspense on past due loans amounted to US\$181.8 million (2013: US\$135.0 million).

At 31st December 2014, the past due but not impaired loan of US\$6.7 million represented a loan guaranteed by a government export credit agency.

10.5 Restructured loans

There were no restructured loans during the years ended 31st December 2014 and 31st December 2013. Restructured loans are loans on which the Group has agreed concessions that would not ordinarily have been accepted, due to the financial position of a customer.

10.6 Collateral

The Group did not take possession of any collateral during the years ended 31st December 2014 and 31st December 2013.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

11. Other assets

	31.12.14	31.12.13
	US\$ millions	US\$ millions
Derivative financial instruments	130.0	174.9
Accrued interest, fees and commissions	93.6	90.0
Prepayments	82.4	54.0
Premises and equipment	45.4	28.3
Deferred items	2.7	3.5
Prepaid pension cost	-	2.7
Other, including accounts receivable	39.1	42.9
	393.2	396.3

Derivative financial instruments represent the positive fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.

The increase in prepayments at 31st December 2014 was attributable to expenditure on new IT systems relating to the Group's new retail bank that was launched in early 2015.

The increase in premises and equipment at 31st December 2014 was principally attributable to capitalised expenditure on new premises in the Kingdom of Saudi Arabia.

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

12. Post retirement benefits

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

The Bank maintains defined contribution pension plans for the majority of its employees. Contributions are based on a percentage of salary. The amounts to be paid as retirement benefits are determined by reference to the amounts of the contributions and investment earnings thereon. The total cost of contributions to defined contribution pension plans for the year ended 31st December 2014 amounted to US\$9.0 million (2013: US\$8.0 million).

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

12. Post retirement benefits (continued)

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

	31.12.14 US\$ millions	31.12.13 US\$ millions
Fair value of plan assets	214.5	201.0
Present value of fund obligations	216.8	198.3
Net (liability) / asset in the consolidated statement of financial position	(2.3)	2.7

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

	2014 US\$ millions	2013 US\$ millions
At 1 st January	201.0	176.8
Included in the consolidated statement of income:-		
- Interest income on the plan assets	8.8	7.9
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements:-		
- Return on plan assets excluding interest income	20.3	13.3
Other movements:-		
- Exchange rate movements	(12.7)	5.0
- Contributions paid by the Group	1.4	1.4
- Benefits paid by the plan	(4.3)	(3.4)
At 31 st December	214.5	201.0

The plan assets at 31st December 2014 comprised exposure to equities, multi-asset funds, and debt and hedging funds in equal proportion and have a quoted price in an active market. The hedging funds are designed to hedge the majority of inflation and interest rate risk.

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

	2014 US\$ millions	2013 US\$ millions
At 1 st January	198.3	180.1
Included in the consolidated statement of income:-		
- Current service cost	0.9	0.7
- Interest cost on the fund obligations	8.6	7.9
Included in the consolidated statement of other comprehensive income:-		
- Remeasurements due to changed actuarial assumptions:-		
- Demographic assumptions	-	(7.4)
- Financial assumptions	25.9	7.2
- Experience	-	8.4
Other movements:-		
- Exchange rate movements	(12.7)	4.8
- Benefits paid by the plan	(4.3)	(3.4)
At 31 st December	216.7	198.3

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

12. Post retirement benefits (continued)

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

	2014 US\$ millions	2013 US\$ millions
At 1 st January	2.7	(3.3)
Net expense included in consolidated statement of income	(0.7)	(0.7)
Remeasurement included in consolidated statement of comprehensive income	(5.6)	5.1
Contributions paid by the Group	1.4	1.4
Exchange rate movements	(0.1)	0.2
At 31 st December	(2.3)	2.7

The Group paid US\$1.4 million in contributions to the plan during 2014 and expects to pay US\$0.8 million during 2015.

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

	2014	2013
Discount rate	3.6%	4.4%
Retail price inflation	3.1%	3.4%
Consumer price inflation	2.1%	2.4%
Pension increase rate	3.1%	3.3%
Salary growth rate	3.0%	3.0%
Average life expectancy (years)	89	89

12.6 Sensitivity information

The present value of the fund's obligations, which has a weighted average duration of 22 years, was calculated based on certain actuarial assumptions. Should any one of the key assumptions change by an amount that is probable whilst holding the other assumptions constant, the present value of the fund's obligations would increase or decrease as follows:-

	2014 US\$ millions
Life expectancy increased by 1 year	0.2
Discount rate increased by 0.1%	0.2
Consumer price inflation increased by 0.1%	0.2
Retail price inflation increased by 0.1%	0.2
Salary growth rate increased by 0.1%	0.2

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

13. Deposits

The geographical composition of total deposits was as follows:-

	31.12.14 US\$ millions	31.12.13 US\$ millions
GCC countries	9,856.0	10,224.8
Other Middle East and North Africa countries	674.8	610.1
Other countries	3,607.1	4,062.7
	14,137.9	14,897.6

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

At 31st December 2014, GCC deposits represented 69.7 per cent of total deposits (2013: 68.6 per cent).

Deposits from other countries during the year ended 31st December 2014 and 31st December 2013 reflected a high level of deposit activity by the Group's London-based subsidiary, Gulf International Bank (UK) Limited.

Total deposits at 31st December 2014 included Shariah-compliant transactions amounting to US\$3,153.7 million (2013: US\$2,897.7 million). Shariah-compliant transactions comprise murabaha contracts. The increase in Shariah-compliant deposits during the year ended 31st December 2014 reflected a generally higher funding requirement associated with higher Shariah-compliant loan volumes.

14. Securities sold under agreements to repurchase

The Group enters into collateralised borrowing transactions (repurchase agreements) in the ordinary course of its financing activities. Collateral is provided in the form of securities held within the investment securities portfolio. At 31st December 2014, the fair value of investment securities that had been pledged as collateral under repurchase agreements was US\$711.3 million (2013: US\$847.7 million). The collateralised borrowing transactions are conducted under standardised terms that are usual and customary for such transactions.

15. Other liabilities

	31.12.14 US\$ millions	31.12.13 US\$ millions
Derivative financial instruments	131.0	192.4
Deferred items	61.9	64.1
Accrued interest	68.8	60.5
Pension liability	2.3	-
Other, including accounts payable and accrued expenses	78.9	82.4
	342.9	399.4

Derivative financial instruments represent the negative fair values of derivative financial instruments entered into for trading purposes, or designated as fair value or cash flow hedges. An analysis of the fair value of derivative financial instruments is set out in note 31.4.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

16. Senior term financing

	Maturity	31.12.14 US\$ millions	31.12.13 US\$ millions
Murabaha term facility	2014	-	300.0
Floating rate repurchase agreements	2014	-	64.9
Floating rate note	2015	932.7	933.2
Floating rate repurchase agreements	2015	35.4	35.4
Floating rate loan	2016	500.0	500.0
Floating rate note	2017	499.6	499.4
Floating rate loans	2018	605.7	-
Floating rate note	2019	533.0	-
Floating rate loan	2019	266.5	-
		3,372.9	2,332.9

During the year ended 31st December 2014, the Group raised US\$1,405.2 million of new senior term finance (2013: nil).

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

At 31st December 2014, the fair value of investment securities that had been pledged as collateral under term repurchase agreements was US\$50.1 million (2013: US\$137.7 million).

17. Subordinated term financing

	Maturity	31.12.14 US\$ millions	31.12.13 US\$ millions
Floating rate note	2015	327.8	327.8
Floating rate loans	2016	150.0	150.0
		477.8	477.8

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

18. Share capital

The authorised share capital at 31st December 2014 comprised 3.0 billion shares of US\$1 each (2013: 3.0 billion shares of US\$1 each). The issued share capital at 31st December 2014 comprised 2.5 billion shares of US\$1 each (2013: 2.5 billion shares of US\$1 each). All issued shares are fully paid.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

19. Reserves

	Share premium US\$ millions	Compulsory reserve US\$ millions	Voluntary reserve US\$ millions	Cash flow hedge reserve US\$ millions	Investment securities revaluation reserve US\$ millions	Total US\$ millions
At 1st January 2014	7.6	206.7	144.2	-	15.8	374.3
Net fair value losses on cash flow hedges	-	-	-	(0.2)	-	(0.2)
Net fair value gains on equity investments classified as FVTOCI	-	-	-	-	3.2	3.2
Transfers to consolidated statement of income	-	-	-	(0.1)	-	(0.1)
Net (decrease) / increase	-	-	-	(0.3)	3.2	2.9
Transfers from retained earnings	-	7.4	7.4	-	-	14.8
At 31st December 2014	7.6	214.1	151.6	(0.3)	19.0	392.0
At 1st January 2013	7.6	196.8	134.3	1.4	(11.9)	328.2
Net fair value gains on cash flow hedges	-	-	-	-	-	-
Net fair value gains on equity investments classified as FVTOCI	-	-	-	-	27.7	27.7
Transfers to consolidated statement of income	-	-	-	(1.4)	-	(1.4)
Net (decrease) / increase	-	-	-	(1.4)	27.7	26.3
Transfers from retained earnings	-	9.9	9.9	-	-	19.8
At 31st December 2013	7.6	206.7	144.2	-	15.8	374.3

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

The investment securities revaluation reserve entirely comprised unrealised fair value gains and losses on equity investments arising since the adoption of IFRS 9 on 1st January 2012.

20. Dividends

No dividend is proposed in respect of the financial year ended 31st December 2014.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

21. Net interest income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Interest income		
Placements and other liquid assets	37.7	31.8
Investment securities	55.2	58.6
Loans and advances	216.0	214.9
Total interest income	308.9	305.3
Interest expense		
Deposits from banks and customers	84.2	82.9
Securities sold under agreements to repurchase	3.4	3.3
Term financing	63.3	56.0
Total interest expense	150.9	142.2
Net interest income	158.0	163.1

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

There was no accrued interest on impaired loans included in interest income for the year ended 31st December 2014 (2013: US\$1.4 million). There was no accrued but uncollected interest included in interest income on past due loans or past due investment securities for either the year ended 31st December 2014 or 31st December 2013.

22. Fee and commission income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Fee and commission income		
Commissions on letters of credit and guarantee	32.1	31.2
Investment banking and management fees	27.9	27.2
Loan commitment fees	2.0	2.5
Other fee and commission income	2.4	2.5
Total fee and commission income	64.4	63.4
Fee and commission expense	(1.5)	(1.4)
Net fee and commission income	62.9	62.0

Investment banking and management fees comprise fees relating to the provision of investment management and financial services, including asset and fund management, underwriting activities, and services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.

Investment banking and management fees for the year ended 31st December 2014 included fee income relating to the Group's fiduciary activities amounting to US\$20.8 million (2013: US\$16.0 million).

Fee and commission expense principally comprises security custody fees.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

23. Foreign exchange income

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

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

24. Trading income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Managed funds	1.2	9.5
Equity securities	0.5	0.9
Interest rate derivatives	0.7	0.2
Debt securities	-	(1.3)
	2.4	9.3

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

Income on managed funds for the year ended 31st December 2013 included an amount of US\$5.9 million in relation to a recovery of an underlying investment in a fund managed by the Group. The amount was written off in a previous year.

25. Other income

	Year ended 31.12.14 US\$ millions	Year ended 31.12.13 US\$ millions
Dividends on equity investments classified as FVTOCI	9.5	9.6
Recoveries on previously written off assets	3.8	15.8
Net realised profits on investment debt securities	1.4	1.1
Sundry income	0.2	-
	14.9	26.5

Recoveries on previously written off assets for the year ended 31st December 2014 principally comprised a US\$3.0 million recovery relating to a previously written off loan and a US\$0.8 million debt security recovery. Recoveries on previously written off assets for the year ended 31st December 2013 principally comprised a US\$15.3 million recovery arising on the liquidation of a structured investment vehicle that was written off in 2007.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

26. Segmental information

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

26.1 Business segments

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

- Wholesale banking: the provision of wholesale commercial financing and other credit facilities for corporate and institutional customers, and the provision of financial advisory services relating to structured financing, privatisations, initial public offerings, and mergers and acquisitions.
- Treasury: the provision of a broad range of treasury and capital market products and services to corporate and financial institution clients, money market, proprietary investment and trading activities and the management of the Group's balance sheet, including funding.
- Financial markets: the provision of asset and fund management services.
- Head office and support units: income arising on the investment of the Group's net free capital funds and expenses incurred by support units, including the investment in the retail banking strategy prior to the public launch of retail banking activities.

The results reported for the business segments are based on the Group's internal financial reporting systems, which report interest revenue and interest expense on a net basis. The accounting policies of the segments are the same as those applied in the preparation of these consolidated financial statements and are set out in note 2. Transactions between business segments are conducted on normal commercial terms and conditions. Transfer pricing between the business units is based on the market cost of funds.

Segment results, assets and liabilities comprise items directly attributable to the business segments. Liabilities reported for head office and support units comprise senior and subordinated term finance facilities and related accrued interest, the cost of which is recharged to the relevant operating business segments.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

26. Segmental information (continued)

26.1 Business segments (continued)

The business segment analysis is as follows:-

	Wholesale banking US\$ millions	Treasury US\$ millions	Financial markets US\$ millions	Head office and support units US\$ millions	Total US\$ millions
2014					
Net interest income	71.0	55.2	-	31.8	158.0
Total income	120.2	76.8	22.6	38.0	257.6
Segment result	67.9	66.6	16.7	(64.3)	86.9
Taxation charge on overseas activities					(1.3)
Net income after tax					85.6
Segment assets	8,086.1	12,846.2	39.0	328.9	21,300.2
Segment liabilities	-	15,014.6	10.7	3,924.2	18,949.5
Total equity					2,350.7
Total liabilities and equity					21,300.2
2013					
Net interest income	60.6	61.8	-	40.7	163.1
Total income	111.1	96.1	24.5	46.6	278.3
Segment result	63.7	84.4	18.6	(44.2)	122.5
Taxation charge on overseas activities					(1.0)
Net income after tax					121.5
Segment assets	8,489.9	12,367.8	40.2	259.0	21,156.9
Segment liabilities	-	15,998.3	8.1	2,886.5	18,892.9
Total equity					2,264.0
Total liabilities and equity					21,156.9

26.2 Geographical segments

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

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

	Total income US\$ millions	2014 Total assets US\$ millions	Total income US\$ millions	2013 Total assets US\$ millions
GCC	206.3	15,720.6	224.5	15,651.7
Other countries	51.3	5,579.6	53.8	5,505.2
	257.6	21,300.2	278.3	21,156.9

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management

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

The principal risks associated with the Group's businesses and the related risk management processes are described in detail in the Basel 2 Pillar 3 disclosure report in the Annual Report, and are summarised below together with additional quantitative analyses:-

27.1 Credit risk

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

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.1 Credit risk (continued)

a) Maximum exposure to credit risk

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

	31.12.14 US\$ millions	31.12.13 US\$ millions
Balance sheet items:-		
Cash and other liquid assets	2,472.6	1,659.4
Securities purchased under agreements to resell	1,305.2	1,742.7
Placements	5,180.5	5,264.6
Trading securities	72.7	50.9
Investment securities	3,944.5	3,725.8
Loans and advances	7,931.5	8,317.2
Accrued interest receivable	93.6	90.0
Total on-balance sheet credit exposure	21,000.6	20,850.6
Off-balance sheet items:-		
Credit-related contingent items	3,976.0	5,140.1
Foreign exchange-related items	195.7	290.5
Derivative-related items	40.7	48.6
Commodity contracts	3.0	-
Total off-balance sheet credit exposure	4,215.4	5,479.2
Total gross credit exposure	25,216.0	26,329.8

b) Credit risk profile

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.1 Credit risk (continued)

b) Credit risk profile (continued)

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.1 Credit risk (continued)

b) Credit risk profile (continued)

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

	31.12.14			31.12.13		
	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions
Neither past due nor impaired						
Rating grades 1 to 4-	8,858.3	3,636.9	4,801.4	8,591.6	3,417.4	5,056.0
Rating grades 5+ to 5-	100.0	-	2,767.8	75.1	-	2,784.0
Rating grades 6+ to 6-	-	-	346.2	-	-	362.2
Equity investments	-	380.3	-	-	359.3	-
Carrying amount	8,958.3	4,017.2	7,915.4	8,666.7	3,776.7	8,202.2
Past due but not impaired						
Rating grades 1 to 7	-	-	6.7	-	-	53.5
Carrying amount	-	-	6.7	-	-	53.5
Past due and individually impaired						
Rating grade 7	-	-	-	-	-	6.8
Rating grade 8	-	-	3.8	-	-	-
Rating grade 9	-	-	5.6	-	-	19.2
Carrying amount	-	-	9.4	-	-	26.0
Individually impaired but not past due						
Rating grade 8	-	-	-	-	-	35.5
Carrying amount	-	-	-	-	-	35.5
	8,958.3	4,017.2	7,931.5	8,666.7	3,776.7	8,317.2

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

Provisions for impairment	-	(3.2)	(601.1)	-	(7.7)	(591.3)
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Individually impaired financial assets represent assets for which there is objective evidence that the Group will not collect all amounts due, including both principal and interest, in accordance with the contractual terms of the obligation.

Unimpaired financial assets are stated net of allocated non-specific provisions for impairment.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.1 Credit risk (continued)

b) Credit risk profile (continued)

The Group holds collateral against loans and advances in the form of physical assets, cash deposits, securities and guarantees. The amount and type of collateral is dependent upon the assessment of the credit risk of the counterparty. The market / fair value of the collateral is actively monitored on a regular basis and requests are made for additional collateral in accordance with the terms of the underlying agreements. Collateral is not usually held against securities or placements and no such collateral was held at either 31st December 2014 or 31st December 2013.

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

c) Credit risk concentration

The Group monitors concentrations of credit risk by sector and by geographic location. The industrial classification of loans and advances is set out in note 10.2. The geographical distribution of risk assets is set out in note 28. An analysis of the credit risk in respect of foreign exchange and derivative financial instruments is set out in note 31.

d) Settlement risk

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

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

27.2 Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk, foreign exchange risk and equity price risk associated with its trading, investment and asset and liability management activities. The portfolio effects of holding a diversified range of instruments across a variety of businesses and geographic areas contribute to a reduction in the potential negative impact on earnings from market risk factors.

a) Trading market risk

The Group's trading activities principally comprise trading in debt and equity securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate, foreign exchange, equity, credit and commodity markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities. VaR is a risk measurement concept which uses statistical models to estimate, within a given level of confidence, the maximum potential negative change in the market value of a portfolio over a specified time horizon resulting from an adverse movement in rates and prices. It is recognised that there are limitations to the VaR methodology. These limitations include the fact that the historical data may not be the best proxy for future price movements. The Group performs regular back testing exercises to compare actual profits and losses with the VaR estimates to monitor the statistical validity of the VaR model. VaR is calculated based on the Group's market risk exposures at the close of the business each day. Intra-day risk levels may vary from those reported at the end of the day. In addition, losses beyond the specified confidence level are not captured by the VaR methodology. VaR is not a measure of the absolute limit of market risk and losses in excess of the VaR amounts will,

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.2 Market risk (continued)

a) Trading market risk (continued)

on occasion, arise. To manage the risk associated with extreme market movements, the Group conducts stress testing which measures the impact of simulated abnormal changes in market rates and prices on the market values of the portfolios. The composition of the debt and equity trading securities is set out in note 8. An analysis of derivative financial instruments, including the VaR of foreign exchange and derivative trading contracts, is set out in note 31.

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

	31.12.14	Average	High	2014 Low	31.12.13	Average	High	2013 Low
	US\$ millions							
Total VaR	0.4	0.1	0.4	-	1.0	1.3	2.3	0.9
Total undiversified stressed VaR	0.6	0.3	1.5	0.1	2.0	3.8	5.3	2.0

b) Non-trading market risk

Structural interest rate risk arises in the Group's core balance sheet as a result of mismatches in the repricing of interest rate sensitive financial assets and liabilities. The associated interest rate risk is managed within VaR limits and through the use of models to evaluate the sensitivity of earnings to movements in interest rates. The repricing profile and related interest rate sensitivity of the Group's financial assets and liabilities are set out in note 30. Movements in the fair value of equity investment securities are accounted for in other comprehensive income. The Group does not maintain material foreign currency exposures. In general, the Group's policy is to match financial assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps. Details of significant foreign currency net open positions are set out in note 31.5.

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.3 Liquidity risk

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

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

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

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

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

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

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

The maturity profile of assets and liabilities is set out in note 29. An analysis of debt investment securities by rating classification is set out in note 27.1.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.4 Operational risk

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

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

27.5 Capital management

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

As referred to in more detail in note 34, the Group adopted the Basel 2 capital adequacy framework with effect from 1st January 2008, and has adopted Basel 3 from 1st January 2015 as required by the CBB. The Basel 3 framework revises the definition of regulatory capital and introduces certain new liquidity and funding ratios. The Group's current capital position is sufficient to meet the new regulatory capital requirements.

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

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

- Tier 1 capital, comprising issued share capital, share premium, retained earnings and reserves, adjusted to exclude revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions and unrealised gains on equity investment securities.
- Tier 2 capital, comprising qualifying subordinated term finance, collective impairment provisions and 45 per cent of unrealised gains arising on the remeasurement to fair value of equity investment securities.

The CBB applies various limits to elements of the capital base. The amount of innovative tier 1 securities cannot exceed 15 per cent of total tier 1 capital; qualifying tier 2 capital cannot exceed tier 1 capital; and qualifying subordinated term finance cannot exceed 50 per cent of tier 1 capital. There are also restrictions on the amount of collective impairment provisions that may be included as part of tier 2 capital. Collective impairment provisions cannot exceed 1.25 per cent of credit risk-weighted assets.

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

27. Risk management (continued)

27.5 Capital management (continued)

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

The Group complied with all externally imposed capital requirements throughout the years ended 31st December 2014 and 31st December 2013.

There have been no material changes in the Group's management of capital during the years ended 31st December 2014 and 31st December 2013.

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

28. Geographical distribution of risk assets

	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Credit- related contingent items US\$ millions	31.12.14 Total US\$ millions	31.12.13 Total US\$ millions
GCC	3,765.0	1,853.6	7,430.9	3,357.0	16,406.5	17,559.1
Other Middle East & North Africa	-	5.8	15.2	25.9	46.9	67.9
Europe	3,972.1	1,315.5	338.8	336.4	5,962.8	5,330.7
North America	804.8	497.6	93.2	224.0	1,619.6	2,039.7
Asia	416.4	334.5	8.0	32.7	791.6	855.1
Latin America	-	10.2	45.4	-	55.6	48.2
	8,958.3	4,017.2	7,931.5	3,976.0	24,883.0	25,900.7

At 31st December 2014, risk exposures to customers and counterparties in the GCC represented 65.9 per cent (2013: 67.8 per cent) of total risk assets. The risk asset profile reflects the Group's strategic focus on wholesale banking activities in the GCC states.

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

An analysis of derivative and foreign exchange instruments is set out in note 31.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

29. Maturities of assets and liabilities

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

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions	Total US\$ millions
At 31st December 2014						
Cash and other liquid assets	2,300.1	172.5	-	-	-	2,472.6
Securities purchased under agreements to resell	1,257.8	47.4	-	-	-	1,305.2
Placements	4,086.2	1,094.3	-	-	-	5,180.5
Trading securities	-	-	-	-	72.7	72.7
Investment securities	433.1	528.1	1,532.8	921.3	529.2	3,944.5
Loans and advances	2,623.0	1,686.5	1,727.0	923.4	971.6	7,931.5
Other assets	115.5	54.5	17.5	-	205.7	393.2
Total assets	10,815.7	3,583.3	3,277.3	1,844.7	1,779.2	21,300.2
Deposits	10,605.7	3,528.0	4.2	-	-	14,137.9
Securities sold under agreements to repurchase	550.1	67.9	-	-	-	618.0
Other liabilities	144.3	45.5	16.0	-	137.1	342.9
Term financing	35.4	1,260.5	1,149.5	1,405.3	-	3,850.7
Equity	-	-	-	-	2,350.7	2,350.7
Total liabilities & equity	11,335.5	4,901.9	1,169.7	1,405.3	2,487.8	21,300.2
At 31st December 2013						
Total assets	10,622.6	3,043.9	3,589.4	2,076.7	1,824.3	21,156.9
Total liabilities & equity	11,988.7	4,252.7	2,023.1	505.2	2,387.2	21,156.9

The asset and liability maturities presented in the table above are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Group's deposit retention records. Formal liquidity controls are nevertheless based on contractual asset and liability maturities.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

29. Maturities of assets and liabilities (continued)

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

	Within 3 months US\$ millions	4 months to 1 year US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years and other US\$ millions
At 31st December 2014					
Deposits	10,619.5	3,551.4	4.5	-	-
Securities sold under agreements to repurchase	550.8	68.1	-	-	-
Term financing	44.8	1,290.0	1,209.2	1,413.6	-
Derivative financial instruments					
- contractual amounts payable	68.6	91.9	162.6	53.4	78.0
- contractual amounts receivable	(74.7)	(112.2)	(185.5)	(62.9)	(50.8)
Total undiscounted financial liabilities	11,209.0	4,889.2	1,190.8	1,404.1	27.2
At 31st December 2013					
Deposits	11,085.2	3,861.6	4.9	-	-
Securities sold under agreements to repurchase	787.1	-	-	-	-
Term financing	9.7	405.5	2,014.1	523.2	-
Derivative financial instruments					
- contractual amounts payable	74.4	123.6	270.3	83.3	45.1
- contractual amounts receivable	(51.2)	(105.1)	(236.9)	(80.3)	(44.4)
Total undiscounted financial liabilities	11,905.2	4,285.6	2,052.4	526.2	0.7

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

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

A maturity analysis of derivative and foreign exchange instruments based on notional amounts is set out in note 31.3.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

30. Interest rate risk

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

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions
At 31st December 2014						
Cash and other liquid assets	2,300.1	172.5	-	-	-	2,472.6
Securities purchased						
under agreements to resell	1,257.8	47.4	-	-	-	1,305.2
Placements	5,163.4	17.1	-	-	-	5,180.5
Trading securities	-	-	-	-	72.7	72.7
Investment securities						
- Fixed rate	-	188.1	155.9	1,202.3	-	1,546.3
- Floating rate	1,545.8	548.0	-	-	(3.2)	2,090.6
- Equities	-	-	-	-	307.6	307.6
Loans and advances	6,139.0	1,839.9	100.6	-	(148.0)	7,931.5
Other assets	-	-	-	-	393.2	393.2
Total assets	16,406.1	2,813.0	256.5	1,202.3	622.3	21,300.2
Deposits	13,362.9	771.9	3.1	-	-	14,137.9
Securities sold under						
agreements to repurchase	550.1	67.9	-	-	-	618.0
Other liabilities	-	-	-	-	342.9	342.9
Term financing	3,190.0	660.7	-	-	-	3,850.7
Equity	-	-	-	-	2,350.7	2,350.7
Total liabilities & equity	17,103.0	1,500.5	3.1	-	2,693.6	21,300.2
Interest rate sensitivity gap	(696.9)	1,312.5	253.4	1,202.3	(2,071.3)	-
Cumulative interest rate						
sensitivity gap	(696.9)	615.6	869.0	2,071.3	-	-
At 31st December 2013						
Cumulative interest rate						
sensitivity gap	(533.5)	1,065.1	1,139.0	2,083.5	-	-

The repricing profile is based on the remaining period to the next interest repricing date. Derivative financial instruments that have been used for asset and liability management purposes to hedge exposure to interest rate risk are incorporated in the repricing profiles of the related hedged assets and liabilities. The non-specific investment security and loan provisions are classified in non-interest bearing items.

The substantial majority of assets and liabilities reprice within one year. Accordingly there is limited exposure to interest rate risk. The principal interest rate risk beyond one year as set out in the asset and liability repricing profile, represents the investment of the Group's net free capital in fixed rate government securities. At 31st December 2014 the modified duration of these fixed rate securities was 2.56. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate securities was US\$311,000.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

30. Interest rate risk (continued)

Based on the repricing profile at 31st December 2014, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent increase in interest rates across all maturities would result in an increase in net income before tax for the following year by approximately US\$0.9 million (2013: US\$1.6 million) and an increase in the Group's equity by US\$0.5 million (2013: US\$0.3 million). The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

The Value-at-Risk by risk class for the Group's trading positions is set out in note 27. The market risk relating to derivative and foreign exchange instruments classified as FVTPL is set out in note 31.

31. Derivatives and foreign exchange instruments

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

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

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

31. Derivatives and foreign exchange instruments (continued)

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

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

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

31.1 Product analysis

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

	Trading US\$ millions	Notional amounts Hedging US\$ millions	Total US\$ millions	Credit risk amounts US\$ millions
At 31st December 2014				
Foreign exchange contracts:-				
Unmatured spot, forward and futures contracts	3,912.4	3,341.4	7,253.8	164.1
Options purchased	1,908.4	-	1,908.4	31.6
Options written	1,908.4	-	1,908.4	-
	7,729.2	3,341.4	11,070.6	195.7
Interest rate contracts:-				
Interest rate swaps	952.2	10,732.9	11,685.1	40.7
Cross currency swaps	-	533.3	533.3	-
Options, caps and floors purchased	12.4	-	12.4	-
Options, caps and floors written	12.4	-	12.4	-
	977.0	11,266.2	12,243.2	40.7
Commodity contracts:-				
Options and swaps purchased	16.2	-	16.2	3.0
Options and swaps written	16.2	-	16.2	-
	32.4	-	32.4	3.0
	8,738.6	14,607.6	23,346.2	239.4
At 31st December 2013	8,188.0	9,748.0	17,936.0	339.1

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

31. Derivatives and foreign exchange instruments (continued)

31.1 Product analysis (continued)

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

At 31st December 2014, the Value-at-Risk of the foreign exchange, interest rate and credit derivative trading contracts analysed in the table above was nil, nil and nil respectively (2013: US\$0.1 million, nil and nil respectively). Value-at-Risk is a measure of market risk exposure and represents an estimate, with a 99 per cent level of confidence, of the potential loss that might arise if the positions were to be held unchanged for ten consecutive business days. The estimate is based on a twelve month historical observation period of unweighted data from the DataMetrics data set.

31.2 Counterparty analysis

	Banks US\$ millions	Governments US\$ millions	Corporates US\$ millions	31.12.14 Total US\$ millions	31.12.13 Total US\$ millions
OECD countries	114.7	65.2	0.3	180.2	297.6
GCC countries	1.1	0.1	48.2	49.4	30.2
Other countries	0.1	-	9.7	9.8	11.3
	115.9	65.3	58.2	239.4	339.1

Credit risk is concentrated on major OECD-based banks and governments.

31.3 Maturity analysis

	Year 1 US\$ millions	Years 2 and 3 US\$ millions	Years 4 and 5 US\$ millions	Over 5 years US\$ millions	Total US\$ millions
At 31st December 2014					
Foreign exchange contracts	9,982.4	1,088.2	-	-	11,070.6
Interest rate contracts	8,713.2	2,237.9	1,008.2	283.9	12,243.2
Commodity contracts	32.4	-	-	-	32.4
	18,728.0	3,326.1	1,008.2	283.9	23,346.2
At 31st December 2013	11,364.4	4,268.4	1,995.7	307.5	17,936.0

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

31. Derivatives and foreign exchange instruments (continued)

31.4 Fair value analysis

	Positive fair value US\$ millions	31.12.14 Negative fair value US\$ millions	Positive fair value US\$ millions	31.12.13 Negative fair value US\$ millions
Derivatives classified as FVTPL:-				
Forward foreign exchange contracts	98.5	(82.2)	139.7	(136.1)
Interest rate swaps and swaptions	31.5	(30.1)	35.2	(33.9)
	130.0	(112.3)	174.9	(170.0)
Derivatives held as fair value hedges:-				
Interest rate swaps	-	(18.7)	-	(22.4)
Amount included in other assets / (other liabilities)	130.0	(131.0)	174.9	(192.4)

31.5 Significant net open positions

There were no significant derivative trading or foreign currency net open positions at either 31st December 2014 or at 31st December 2013.

31.6 Hedge effectiveness

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

	2014 US\$ millions	2013 US\$ millions
Net (losses) / gains on derivatives fair value hedging instruments	(2.3)	28.4
Net gains / (losses) on hedged items attributable to the hedged risk	2.3	(28.4)

There were no ineffective portions of derivative fair value or cash flow hedging transactions recognised in the consolidated statement of income in either the year ended 31st December 2014 or 31st December 2013.

Certain derivative cash flow hedging transactions were unwound during the year ended 31st December 2009. The resultant realised profits are being recognised in the consolidated statement of income over the respective tenors of the original transactions for periods to 2014.

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

32. Credit-related financial instruments

Credit-related financial instruments include commitments to extend credit, standby letters of credit and guarantees which are designed to meet the financing requirements of customers. The credit risk on these transactions is generally less than the contractual amount. The table below sets out the notional principal amounts of outstanding credit-related contingent items and the risk-weighted exposures calculated in accordance with the CBB's Basel 2 guidelines.

	Notional principal amount US\$ millions	31.12.14 Risk- weighted exposure US\$ millions	Notional principal amount US\$ millions	31.12.13 Risk- weighted exposure US\$ millions
Direct credit substitutes	528.3	470.5	522.4	478.6
Transaction-related contingent items	2,058.2	798.3	2,482.1	917.0
Short-term self-liquidating trade-related contingent items	498.4	75.0	707.0	106.1
Commitments, including undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	891.1	373.3	1,428.6	452.1
	3,976.0	1,717.1	5,140.1	1,953.8

Commitments may be drawdown on demand.

Direct credit substitutes at 31st December 2014 included financial guarantees amounting to US\$467.2 million (2013: US\$432.3 million). Financial guarantees may be called on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2014, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US\$526.9 million (2013: US\$985.8 million).

33. Contingent liabilities

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

34. Capital adequacy

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014**34. Capital adequacy (continued)**

The risk asset ratio calculated in accordance with the CBB's Basel 2 guidelines was as follows:-

	31.12.14 US\$ millions	31.12.13 US\$ millions		
Regulatory capital base				
Tier 1 capital:-				
Total equity	2,350.7	2,264.0		
Tier 1 adjustments	(39.7)	(78.2)		
Tier 1 capital	2,311.0	2,185.8		
Tier 2 capital:-				
Subordinated term financing	30.0	125.6		
Non-specific provisions (subject to 1.25% credit risk-weighted exposure limit)	151.2	152.5		
Tier 2 adjustments	17.9	(23.0)		
Tier 2 capital	199.1	255.1		
Total regulatory capital base	2,510.1	2,440.9		
	Notional principal amount US\$ millions	Risk-weighted exposure US\$ millions	Notional principal amount US\$ millions	Risk-weighted exposure US\$ millions
Risk-weighted exposure				
<i>Credit risk</i>				
Balance sheet items:-				
Cash and other liquid assets	2,472.6	125.9	1,659.4	70.4
Securities purchased under agreements to resell	1,305.2	10.1	1,742.7	21.2
Placements	5,180.5	968.3	5,264.6	1,023.2
Investment securities	3,944.5	1,329.1	3,725.8	1,302.0
Loans and advances	7,931.5	7,587.3	8,317.2	7,507.4
Other assets, excluding derivative-related items	263.2	232.7	221.4	185.4
		10,253.4		10,109.6
Off-balance sheet items:-				
Credit-related contingent items	3,976.0	1,717.1	5,140.1	1,953.8
Foreign exchange-related items	11,070.6	103.6	8,607.1	80.0
Derivative-related items	12,243.2	33.5	9,328.9	19.7
Commodity contracts	32.4	-	-	-
Forward placements	60.3	12.1	51.9	6.4
Repo counterparty risk	-	37.3	-	33.5
		1,903.6		2,093.4
Credit risk-weighted exposure		12,157.0		12,203.0
<i>Market risk</i>				
General market risk		43.9		151.0
Specific market risk		39.8		47.2
Market risk-weighted exposure		83.7		198.2
<i>Operational risk</i>				
Operational risk-weighted exposure		541.4		520.4
Total risk-weighted exposure		12,782.1		12,921.6
Tier 1 risk asset ratio		18.1%		16.9%
Total risk asset ratio		19.6%		18.9%

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

34. Capital adequacy (continued)

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

In accordance with the capital adequacy guidelines of the CBB, revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions and unrealised gains on equity investment securities are excluded from tier 1 capital. In accordance with the CBB's guidelines, gains arising on the remeasurement to fair value of equity investment securities are included in tier 2 capital, although limited to 45 per cent of the unrealised revaluation gain.

The Group's subordinated term financing facilities have been approved for inclusion in tier 2 capital by the CBB. During the last five years before maturity, a cumulative amortisation (discount) factor of 20 per cent per year is to be applied to the facilities. As at 31st December 2014, the amortisation amount excluded from tier 2 capital amounted to US\$447.8 million (2013: US\$352.2 million).

The Group calculates the regulatory capital requirement for general market risk using a Value-at-Risk model. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the Bank's regulator, the CBB. The multiplication factor to be applied to the Value-at-Risk calculated by the internal model has been set at 3.0 (2013: 3.0) by the CBB, representing the regulatory minimum. During 2012, the CBB implemented revisions to the market risk framework, which have become known as Basel 2.5. Consequently, the inclusion of metrics such as a 'stressed VaR' measure has been included in the calculation of the regulatory capital requirement.

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

35. Fiduciary activities

The Group conducts investment management and other fiduciary activities on behalf of clients. Assets held in trust or in a fiduciary capacity are not assets of the Group and accordingly have not been included in the consolidated financial statements. The aggregate amount of the funds concerned at 31st December 2014 was US\$12,964.5 million (2013: US\$11,152.5 million).

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

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

The maximum exposure to loss is equal to the carrying amount of the trading securities, which at 31st December 2014 amounted to US\$59.0 million (2013: US\$49.1 million).

36. Related party transactions

The Group is owned by the six Gulf Cooperative Council (GCC) governments, with the Public Investment Fund holding a majority (97.2 per cent) controlling stake. The Public Investment Fund is an investment body of the Saudi Arabian Ministry of Finance. There were no individual or collectively significant transactions with the Public Investment Fund during the years ended 31st December 2014 or 31st December 2013, other than the senior term loan referred to in note 16.

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

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

The compensation of key management personnel was as follows:-

	2014	2013
	US\$ millions	US\$ millions
Short-term employee benefits	8.1	8.5
Post-employment benefits	0.4	0.5
	8.5	9.0

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

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

37. Fair value of financial instruments

The Group's financial instruments are accounted for under the historical cost method with the exception of trading securities, equity investment securities and derivative financial instruments, which are accounted for at fair value. The fair value represents the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. Differences therefore can arise between book values under the historical cost method and fair value estimates. Underlying the definition of fair value is the presumption that the Group is a going concern without any intention or requirement to curtail materially the scale of its operation or to undertake a transaction on adverse terms. Generally accepted methods of determining fair value include reference to quoted prices (level 1 measurement) or to the pricing prevailing for similar financial instruments (level 2 measurement) and the use of unobservable inputs in estimation techniques such as discounted cash flow analysis (level 3 measurement).

The valuation methodologies applied are outlined below.

37.1 Trading securities

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

37.2 Investment securities

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

37.3 Loans and advances

The fair values (level 2) of loans on a floating interest rate basis are principally estimated at book value. The fair values (level 3) of impaired loans are estimated at the recoverable amount, measured as the present value of expected future cash flows discounted based on the interest rate at the inception of the loan. The fair values of fixed rate loans are estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality. The fair values (level 2) approximate the carrying values.

37.4 Term financing

The fair value of term financing is based on observable market data, including quoted market prices for debt instruments issued by similarly rated financial institutions and with similar maturities, or estimated on a discounted cash flow basis utilising currently prevailing spreads for borrowings with similar maturities. The fair values (level 2) of senior term financing and subordinated term financing at 31st December 2014 approximate their respective book values.

37.5 Other on-balance sheet items

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

37.6 Credit-related contingent items

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

37. Fair value of financial instruments (continued)

37.7 Valuation basis

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

	Quoted prices (level 1) US\$ millions	Valuation based on observable market data (level 2) US\$ millions	Other valuation techniques (level 3) US\$ millions
At 31st December 2014			
Financial assets:-			
Trading securities	71.1	1.6	-
Investment securities - equities	183.5	-	124.1
Derivative financial instruments	-	130.0	-
Financial liabilities:-			
Derivative financial instruments	-	131.0	-
At 31st December 2013			
Financial assets:-			
Trading securities	49.1	1.8	-
Investment securities - equities	175.8	-	132.6
Derivative financial instruments	-	174.9	-
Financial liabilities:-			
Derivative financial instruments	-	192.4	-

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

During the year ended 31st December 2014, the value of investment securities whose measurement was determined by other valuation techniques (level 3 measurement) decreased by US\$8.5 million (2013: increase of US\$3.3 million). The decrease principally comprised changes in assigned valuations as recognised in other comprehensive income. No transfers out of, or into, the level 3 measurement classification occurred during the years ended 31st December 2014 and 31st December 2013. Similarly, no transfers between level 1 and level 2 measurement classifications were made during the years ended 31st December 2014 and 31st December 2013.

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

Notes to the consolidated financial statements (continued)

For the year ended 31st December 2014

38. Earnings per share

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

	2014	2013
Net income (US\$ millions)	85.6	121.5
Weighted average number of shares in issue (millions)	2,500	2,500
Basic earnings per share (US\$)	0.03	0.05

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

39. Principal subsidiaries

The principal subsidiary companies were as follows:-

	Principal activities	Country of incorporation
Gulf International Bank (UK) Limited	Asset management	United Kingdom
GIB Capital L.L.C.	Investment banking	Kingdom of Saudi Arabia

The Group's ownership interest in the principal subsidiary companies was 100 per cent for the years ended 31st December 2014 and 31st December 2013.

40. Average consolidated statement of financial position

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

	31.12.14 US\$ millions	31.12.13 US\$ millions
ASSETS		
Cash and other liquid assets	2,210.4	1,476.4
Securities purchased under agreements to resell	2,645.6	1,514.5
Placements	5,395.6	5,519.1
Trading securities	60.3	89.6
Investment securities	3,722.9	3,727.1
Loans and advances	8,205.4	7,882.0
Other assets	414.7	309.5
Total assets	22,654.9	20,518.2
LIABILITIES		
Deposits from banks	1,420.5	1,892.4
Deposits from customers	14,398.4	12,532.8
Securities sold under agreements to repurchase	729.8	691.2
Other liabilities	344.0	324.3
Senior term financing	2,960.1	2,381.1
Subordinated term financing	477.8	477.8
Total liabilities	20,330.6	18,299.6
Total equity	2,324.3	2,218.6
Total liabilities & equity	22,654.9	20,518.2

Risk management and capital adequacy report

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Risk management and capital adequacy report

31st December 2014

Executive summary

The Central Bank of Bahrain (CBB) Basel 2 guidelines prescribe the capital adequacy framework for banks incorporated in the Kingdom of Bahrain. GIB (the Group), adopted the Basel 2 capital adequacy framework with effect from 1st January 2008, and has adopted Basel 3 from 1st January 2015 as required by the CBB. The Basel 3 framework revises the definition of regulatory capital and introduces certain new liquidity and funding ratios. The Group's current capital position is sufficient to meet the new regulatory capital requirements.

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

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

For regulatory purposes, GIB has adopted the standardised approach for credit risk. In time and subject to the CBB permitting the use of the internal ratings based approach, GIB plans to adopt the FIRB approach for credit risk, as it is more closely aligned to the Group's internal capital management methodologies. GIB uses the internal models approach for market risk and the standardised approach for determining the capital requirement for operational risk.

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

GIB's total risk-weighted assets at 31st December 2014 amounted to US\$12,782.1 million. Credit risk accounted for 95.1 per cent, market risk 0.7 per cent and operational risk 4.2 per cent of the total risk-weighted assets. Tier 1 and total regulatory capital were US\$2,311.0 million and US\$2,510.1 million respectively.

At 31st December 2014, GIB's tier 1 and total capital adequacy ratios were 18.1 per cent and 19.6 per cent respectively. GIB aims to maintain a tier 1 capital adequacy ratio above 8 per cent and a total capital adequacy ratio in excess of 12 per cent.

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

All figures presented in this report are as at 31st December 2014 unless otherwise stated.

Risk management and capital adequacy report (continued)

31st December 2014

1. The Basel 2 framework

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

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

1.1 Pillar 1

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

With the introduction of Pillar 2, the CBB will implement a minimum ratio threshold to be determined for each institution individually, as described in more detail in the Pillar 2 section of this report. As at 31st December 2014, and pending the finalisation of the CBB's Pillar 2 guidelines, all banks incorporated in Bahrain are required to maintain a minimum capital adequacy ratio of 12 per cent.

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

The table below summarises the approaches available for calculating RWAs for each risk type in accordance with the CBB's Basel 2 capital adequacy framework:-

Approaches for determining regulatory capital requirements		
Credit risk	Market risk	Operational risk
Standardised approach	Standardised approach	Basic indicator approach
Foundation internal ratings based approach (FIRB)	Internal models approach	Standardised approach

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

a) Credit risk

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

1. The Basel 2 framework (continued)

1.1 Pillar 1 (continued)

b) Market risk

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

c) Operational risk

Under the CBB's Basel 2 capital adequacy framework, all banks incorporated in Bahrain are required to apply the basic indicator approach for operational risk unless approval is granted by the CBB to use the standardised approach. The CBB's Basel 2 guidelines do not currently permit the use of the advanced measurement approach (AMA) for operational risk. The standardised approach for the calculation of regulatory operational risk capital has been approved by the CBB.

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

1.2 Pillar 2

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

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

Pillar 2 comprises two processes:-

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

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

1. The Basel 2 framework (continued)

1.3 Pillar 3

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

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

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

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

2. Group structure and overall risk and capital management

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

2.1 Group structure

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

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

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

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

Subsidiary	Domicile	Ownership	Consolidation basis
Gulf International Bank (UK) Limited	United Kingdom	100%	Aggregation
GIB Capital LLC	Saudi Arabia	100%	Full Consolidation

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.2 Risk and capital management

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

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

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

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

From a control perspective, the process of risk management is facilitated through a set of independent functions, which report directly to senior management. These functions include Credit Risk, Market Risk, Operational Risk, Financial Control and Internal Audit. This multi-faceted approach aids the effective management of risk by identifying, measuring and monitoring risks from a variety of perspectives.

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.2 Risk and capital management (continued)

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

Board of Directors		
Board Audit Committee	Board Risk Policy Committee	
Chief Executive Officer		
Management Committee (Chairman: CEO)	Group Risk Committee (Chairman: CRO)	Assets and Liabilities Committee (Chairman: CFO)

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

Chief Executive Officer	
Chief Financial Officer (CFO)	Chief Risk Officer (CRO)
Balance sheet management framework Capital management framework	Risk management framework and policies Group credit control Credit risk Market risk Operational risk Liquidity risk

2.3 Risk types

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

2.4 Risk in Pillar 1

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

a) Credit risk

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

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.4 Risk in Pillar 1 (continued)

a) Credit risk (continued)

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

b) Market risk

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

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.4 Risk in Pillar 1 (continued)

b) Market risk (continued)

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

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

A key element in the Group's market risk management framework is the estimation of potential future losses that may arise from adverse market movements. The Group utilises Value-at-Risk (VaR) to estimate such losses. The VaR is derived from quantitative models that use statistical and simulation methods that take account of all market rates and prices that may cause a change in a position's value. These include interest rates, foreign exchange rates and equity prices, their respective volatilities and the correlations between these variables. The Group's VaR is calculated on a Monte Carlo simulation basis using historical volatilities and correlations to generate a profit and loss distribution from several thousand scenarios.

The VaR takes account of potential diversification benefits of different positions both within and across different portfolios. Consistent with general market practice, VaR is computed for all financial instruments for which there are readily available daily prices or suitable proxies. VaR is viewed as an effective risk management tool and a valuable addition to the non-statistically based limit structure. It permits a consistent and uniform measurement of market risk across all applicable products and activities. Exposures are monitored against a range of limits both by risk category and portfolio and are regularly reported to and reviewed by senior management and the Board of Directors.

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (i.e. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are regularly conducted to estimate the potential economic losses in such abnormal markets. Stress testing combined with VaR provides a more comprehensive picture of market risk. The Group regularly performs stress tests that are constructed around changes in market rates and prices resulting from pre-defined market stress scenarios, including both historical and hypothetical market events. Historical scenarios include the 1997 Asian crisis, the 1998 Russian crisis, the events of 9/11 and the 2008 credit crisis. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

c) Operational risk

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.4 Risk in Pillar 1 (continued)

c) Operational risk (continued)

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

The Group has an independent operational risk function. As part of the Group's Operational Risk Management Framework (ORMF), comprehensive risk assessments are conducted, which identify operational risks inherent in the Group's activities, processes and systems. The controls in place to mitigate these risks are also reviewed, and enhanced if necessary.

2.5 Risk in Pillar 2

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

a) Liquidity risk

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

- forced sale of assets at below normal market prices
- raising of deposits or borrowing funds at excessive rates
- the investment of surplus funds at below market rates

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

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

The management of liquidity and funding is primarily conducted in the Group's individual geographic entities within approved limits. The limits ensure that contractual net cash flows occurring over the following 30 day period do not exceed the eligible stock of available liquid resources.

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

Risk management and capital adequacy report (continued)

31st December 2014

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

2.5 Risk in Pillar 2 (continued)

a) Liquidity risk (continued)

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

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

b) Interest rate risk in the banking book

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

c) Business risk

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

d) Concentration risk

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

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

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

2.6 Monitoring and reporting

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

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

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

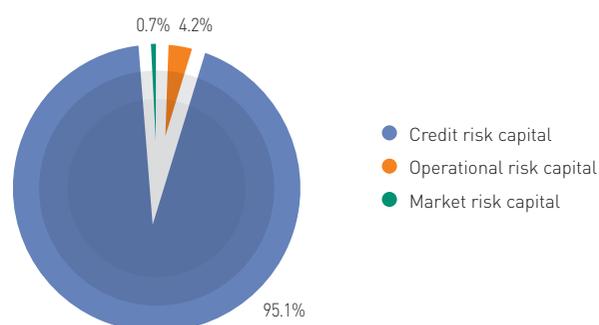
Risk management and capital adequacy report (continued)

31st December 2014

3. Regulatory capital requirements and the capital base

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

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



3.1 Capital requirements for credit risk

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

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

	Rated exposure US\$ millions	Unrated exposure US\$ millions	Total exposure US\$ millions	Average risk weight %	RWA US\$ millions	Capital requirement US\$ millions
Sovereigns	5,091.3	4.5	5,095.8	0%	9.4	1.1
PSEs	-	1.7	1.7	100%	1.7	0.2
Banks	7,936.5	216.4	8,152.9	28%	2,302.2	276.3
Corporates	1,064.4	8,684.5	9,748.9	94%	9,176.0	1,101.1
Equities	-	340.4	340.4	124%	423.3	50.8
Past due loans	-	28.0	28.0	100%	28.0	3.4
Other assets	12.9	214.3	227.2	95%	216.4	26.0
	14,105.1	9,489.8	23,594.9	52%	12,157.0	1,458.8

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

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

3.2 Capital requirements for market risk

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

The VaR calculated by the internal model is subject to a multiplication factor determined by the CBB. GIB's multiplication factor has been set at the regulatory minimum of 3.0 by the CBB.

Prescribed additions in respect of specific risk are made to general market risk. The resultant measure of market risk is multiplied by 12.5, the reciprocal of the theoretical 8 per cent minimum capital ratio, to give market risk-weighted exposure on a basis consistent with credit risk-weighted exposure.

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

	RWA US\$ millions	Capital requirement US\$ millions
Interest rate risk	3.8	0.5
Equities	35.9	4.3
Foreign exchange risk	4.2	0.5
Total general market risk	43.9	5.3
Total specific market risk	39.8	4.8
	83.7	10.1

From April 2012, the general market risk calculation includes the addition of stressed VaR in accordance with CBB guidelines.

3.3 Capital requirements for operational risk

For regulatory reporting purposes, the capital requirement for operational risk is calculated according to the standardised approach. Under this approach, the Group's average gross income over the preceding three financial years is multiplied by a range of beta coefficients. The beta coefficients are determined based on the business line generating the gross income and are prescribed in the CBB's Basel 2 capital adequacy framework and range from 12 to 18 per cent.

The capital requirement for operational risk at 31st December 2014 amounted to US\$65.0 million.

Risk management and capital adequacy report (continued)

31st December 2014

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

3.4 Capital base

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

	Tier 1 US\$ millions	Tier 2 US\$ millions	Total US\$ millions
Share capital	2,500.0	-	2,500.0
Share premium	7.6	-	7.6
Compulsory reserve	214.1	-	214.1
Voluntary reserve	151.6	-	151.6
Retained earnings	(541.3)	-	(541.3)
Unrealised (losses) / gains on fair valuing equity investments	(21.0)	17.9	(3.1)
Collective impairment provisions (subject to 1.25% credit RWA limitation)	-	151.2	151.2
Subordinated term finance	-	30.0	30.0
Tier 1 and tier 2 capital base	2,311.0	199.1	2,510.1

Tier 1 capital is defined as capital of the same or close to the character of paid up capital and comprises share capital, share premium, retained earnings and eligible reserves. Retained earnings, after inclusion of full year profits, are included in tier 1 following the external audit. Eligible reserves exclude revaluation gains and losses arising on the remeasurement to fair value of derivative cash flow hedging transactions, although include unrealised gains and losses arising on the remeasurement to fair value of equity investment securities classified as fair value through other comprehensive income (FVTOCI). Unrealised losses on equity investment securities classified as FVTOCI are included in tier 1 capital and unrealised gains are included in tier 2 capital.

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

The subordinated term finance facilities, amounting to US\$30.0 million, represent unsecured obligations of the Group and are subordinated in right of payment to the claims of depositors and other creditors of the Group that are not also subordinated. The subordinated term finance has been approved for inclusion in tier 2 capital for regulatory capital adequacy purposes by the CBB. During the last five years before contractual maturity, a cumulative amortisation (discount) factor of 20 per cent per year is to be applied to the facilities. At 31st December 2014, the amortisation amount excluded from tier 2 capital amounted to US\$447.8 million.

In accordance with the CBB single obligor regulations, certain large single obligor exposures that were pre-approved by the CBB are required to be treated as regulatory capital deductions. The deductions are applied 50 per cent against tier 1 and 50 per cent against tier 2. At 31st December 2014, the Group had no large single obligor exposures that required deduction from regulatory capital.

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

Risk management and capital adequacy report (continued)

31st December 2014

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

3.4 Capital base (continued)

In accordance with the CBB's Basel 2 capital adequacy framework, securitisation exposures that are rated below BB- or that are unrated are to be deducted from regulatory capital rather than included in RWAs. At 31st December 2014, the Group had no exposure to securitisations.

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

4. Credit risk – Pillar 3 disclosures

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

4.1 Definition of exposure classes

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

Sovereigns portfolio

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

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

PSE portfolio

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

Banks portfolio

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

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

Corporates portfolio

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.1 Definition of exposure classes (continued)

Equities portfolio

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

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

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

Past due exposures

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

Other assets and holdings of securitisation tranches

Cash balances are risk-weighted at 0 per cent, other assets are risk-weighted at 100 per cent.

Securitisation tranches are risk-weighted based on their external credit ratings and tenor. Risk-weightings range from 20 per cent to 650 per cent. Exposures to securitisation tranches that are rated below BB- or are unrated are deducted from regulatory capital rather than being subject to a risk weight.

4.2 External rating agencies

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

4.3 Credit risk presentation under Basel 2

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

- Under the CBB's Basel 2 framework, off-balance sheet exposures are converted into credit exposure equivalents by applying a credit conversion factor (CCF). The off-balance sheet exposure is multiplied by the relevant CCF applicable to the off-balance sheet exposure category. Subsequently, the exposure is treated in accordance with the standard portfolios referred to in section 4.1 of this report in the same manner as on-balance sheet exposures.
- Credit risk exposure reporting under Pillar 3 is frequently reported by standard portfolios based on the type of counterparty. The financial statement presentation is based on asset class rather than the relevant counterparty. For example, a loan to a bank would be classified in the Banks standard portfolio under the capital adequacy framework although is classified in loans and advances in the consolidated financial statements.
- Certain eligible collateral is applied to reduce exposure under the Basel 2 capital adequacy framework, whereas no such collateral netting is applicable in the consolidated financial statements.

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.3 Credit risk presentation under Basel 2 (continued)

- Based on the CBB's Basel 2 guidelines, certain exposures are either included in, or deducted from, regulatory capital rather than treated as an asset as in the consolidated financial statements.
- Under the CBB's Basel 2 capital adequacy framework, external rating agency ratings are based on the highest rating from the lowest two ratings, while for internal credit risk management purposes the Group uses the lowest rating.

4.4 Credit exposure

a) Gross credit exposure

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

	Gross credit exposure US\$ millions	Average gross credit exposure US\$ millions
Balance sheet items:-		
Cash and other liquid assets	2,472.6	2,210.4
Securities purchased under agreements to resell	1,305.2	2,645.6
Placements	5,180.5	5,395.6
Trading securities	72.7	60.3
Investment securities	3,944.5	3,722.9
Loans and advances	7,931.5	8,205.4
Accrued interest receivable	93.6	94.7
Total on-balance sheet credit exposure	21,000.6	22,334.9
Off-balance sheet items:-		
Credit-related contingent items	3,976.0	4,725.3
Derivative and foreign exchange instruments	239.4	315.7
Total off-balance sheet credit exposure	4,215.4	5,041.0
Total gross credit exposure	25,216.0	27,375.9

The average gross credit exposure is based on daily averages during the year ended 31st December 2014.

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

b) Credit exposure by geography

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

	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Accrued interest receivable US\$ millions	Off-balance sheet items US\$ millions	Total US\$ millions
GCC	3,765.0	1,853.6	7,430.9	56.8	3,425.2	16,531.5
Other MENA	-	5.8	15.2	0.1	25.9	47.0
Europe	3,972.1	1,315.5	338.8	27.7	458.4	6,112.5
North America	804.8	497.6	93.2	5.0	248.4	1,649.0
Asia	416.4	334.5	8.0	3.8	57.5	820.2
Latin America	-	10.2	45.4	0.2	-	55.8
	8,958.3	4,017.2	7,931.5	93.6	4,215.4	25,216.0

The MENA region comprises the Middle East and North Africa.

c) Credit exposure by industrial sector

The classification of credit exposure by industrial sector was as follows:-

	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Accrued interest receivable US\$ millions	Off-balance sheet items US\$ millions	Total US\$ millions
Financial services	5,403.2	1,712.5	1,297.5	43.4	529.8	8,986.4
Government	3,555.1	1,423.6	-	15.6	154.4	5,148.7
Energy, oil and petrochemical	-	357.4	1,898.3	8.7	680.1	2,944.5
Construction	-	-	663.9	3.2	1,969.4	2,636.5
Trading and services	-	6.9	1,617.0	5.6	316.5	1,946.0
Transportation	-	49.8	993.5	2.0	107.7	1,153.0
Manufacturing	-	-	878.0	3.2	225.5	1,106.7
Equity investments	-	380.3	-	-	3.2	383.5
Communication	-	68.2	249.0	1.1	45.8	364.1
Real estate	-	18.5	133.2	0.5	0.2	152.4
Other	-	-	201.1	10.3	182.8	394.2
	8,958.3	4,017.2	7,931.5	93.6	4,215.4	25,216.0

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

d) Credit exposure by internal rating

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

	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Accrued interest receivable US\$ millions	Off-balance sheet items US\$ millions	Total US\$ millions
Neither past due nor impaired						
Rating grades 1 to 4-	8,858.3	3,636.9	4,801.4	80.9	1,861.8	19,239.3
Rating grades 5+ to 5-	100.0	-	2,767.8	12.1	2,255.5	5,135.4
Rating grades 6+ to 6-	-	-	346.2	0.6	76.8	423.6
Rating grades 7	-	-	-	-	13.3	13.3
Rating grades 8	-	-	-	-	4.8	4.8
Equity investments	-	380.3	-	-	3.2	383.5
Carrying amount	8,958.3	4,017.2	7,915.4	93.6	4,215.4	25,199.9
Past due but not impaired						
Rating grades 1 to 7	-	-	6.7	-	-	6.7
Carrying amount	-	-	6.7	-	-	6.7
Past due and individually impaired						
Rating grade 8	-	-	3.8	-	-	3.8
Rating grade 9	-	-	5.6	-	-	5.6
Carrying amount	-	-	9.4	-	-	9.4
	8,958.3	4,017.2	7,931.5	93.6	4,215.4	25,216.0

The analysis is presented prior to the application of credit risk mitigation techniques.

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

e) Credit exposure by maturity

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

	Placements, reverse repos & other liquid assets US\$ millions	Securities US\$ millions	Loans and advances US\$ millions	Accrued interest receivable US\$ millions	Total US\$ millions
Within 3 months	7,644.1	433.1	2,623.0	74.2	10,774.4
4 months to 1 year	1,314.2	528.1	1,686.5	19.4	3,548.2
Years 2 to 5	-	2,454.1	2,650.4	-	5,104.5
Years 6 to 10	-	198.1	698.1	-	896.2
Years 11 to 20	-	26.7	257.2	-	283.9
Over 20 years and other	-	377.1	16.3	-	393.4
	8,958.3	4,017.2	7,931.5	93.6	21,000.6

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

Securities exposure over 20 years comprises equity investments and the securities non-specific provision.

f) Equities held in the banking book

Equity investments included in investment securities in the consolidated balance sheet are included in the equities standard portfolio in the Pillar 1 credit risk capital adequacy framework. Such equity investment securities principally comprise listed equities received in settlement of a past due loan, investments of a private equity nature, and investments in funds managed by specialist managers.

At 31st December 2014, equity investment securities held in the banking book amounted to US\$307.6 million, of which US\$174.8 million comprised listed equities received in settlement of a secured past due loan and US\$21.8 million comprised managed funds.

During the year ended 31st December 2014, US\$3.8 million of gains were realised on equity investments. At 31st December 2014, gross unrealised gains on equity investment securities amounted to US\$39.7 million. 45 per cent of the unrealised gains, or US\$17.9 million, was included in tier 2 capital. Gross unrealised losses on equity investment securities amounted to US\$21.0 million and were deducted from tier 1 capital in accordance with the CBB's Basel 2 capital adequacy framework.

g) Credit risk mitigation

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

g) Credit risk mitigation (continued)

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

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

Description of the main types of credit risk mitigation

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

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

	Exposure before credit risk mitigation US\$ millions	Eligible collateral US\$ millions	Eligible guarantees or credit derivatives US\$ millions
Sovereigns	50.2	-	50.2
Banks	2,533.8	1,955.5	532.3
Corporates	259.3	122.1	-

Guarantees and credit derivatives

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

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.4 Credit exposure (continued)

g) Credit risk mitigation (continued)

Collateral and valuation principles

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

Types of eligible collateral commonly accepted

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

4.5 Impaired credit facilities and provisions for impairment

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.5 Impaired credit facilities and provisions for impairment (continued)

a) Impaired loan facilities and related provisions for impairment

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

	Gross exposure US\$ millions	Impairment provisions US\$ millions	Net exposure US\$ millions
Corporates	335.1	325.7	9.4
Financial institutions	127.4	127.4	-
	462.5	453.1	9.4

The gross amount of specifically provisioned loans at 31st December 2014 was US\$462.5 million. Total specific provisions at 31st December 2014 represented 98.0 per cent of loans against which a specific provision had been made.

The impaired loan facilities were principally to counterparties in the GCC.

b) Provisions for impairment – loans and advances

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

	Specific provisions			Collective provisions US\$ millions	Total provisions US\$ millions
	Corporates US\$ millions	Financial institutions US\$ millions	Total US\$ millions		
At 1 st January 2014	295.5	127.8	423.3	168.0	591.3
Exchange rate movements	(0.1)	(0.4)	(0.5)	-	(0.5)
Amounts reallocated	20.0	-	20.0	(20.0)	-
Charge for the year	10.3	-	10.3	-	10.3
At 31st December 2014	325.7	127.4	453.1	148.0	601.1

c) Impaired investment securities and related provisions for impairment

There were no impaired debt investment securities at 31st December 2014.

d) Provisions for impairment – investment securities

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

	Specific provisions US\$ millions	Collective provisions US\$ millions	Total provisions US\$ millions
At 1 st January 2014	-	7.7	7.7
Release for the year	-	(4.5)	(4.5)
At 31st December 2014	-	3.2	3.2

At 31st December 2014, the provisions for the impairment of investment securities entirely comprised non-specific provisions for debt investment securities determined on a collective basis.

Risk management and capital adequacy report (continued)

31st December 2014

4. Credit risk – Pillar 3 disclosures (continued)

4.5 Impaired credit facilities and provisions for impairment (continued)

d) Provisions for impairment – investment securities (continued)

The provision release during the year ended 31st December 2014 arose on an adjustment to the historical loss estimate to reflect the effects of current conditions in relation to the investment-grade rated debt securities. The probabilities of default applied in the calculation of the collective provisions for impairment at 31st December 2014 nevertheless continued to reflect stressed probabilities of default and exceeded prevailing default levels.

4.6 Past due facilities

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

a) Loans

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

	Gross US\$ millions	Carrying amount US\$ millions
Corporates	335.1	9.4
Financial Institutions	134.1	6.7
	469.2	16.1

The past due loan facilities were principally to counterparties in the GCC.

Non-specific loan provisions of US\$148.0 million represented 9.2 times the net carrying amount of past due loans.

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

	Less than 1 year US\$ millions	Years 2 and 3 US\$ millions	Over 3 years US\$ millions	Total US\$ millions
Corporates	66.7	41.7	226.7	335.1
Financial Institutions	-	6.7	127.4	134.1
	66.7	48.4	354.1	469.2

b) Investment securities

There were no debt investment securities for which either principal or interest was over 90 days past due.

Risk management and capital adequacy report (continued)

31st December 2014

5. Market risk – Pillar 3 disclosures

5.1 Market risk

Market risk is the risk of loss due to adverse changes in interest rates, foreign exchange rates, equity prices and market conditions, such as liquidity. The principal market risks to which the Group is exposed are interest rate risk and foreign exchange risk associated with its trading, investment and asset and liability management activities. The portfolio effects of holding a diversified range of instruments across a variety of businesses and geographic areas contribute to a reduction in the potential negative impact on earnings from market risk factors.

The Group's trading and foreign exchange activities principally comprise trading in debt securities, foreign exchange and derivative financial instruments. Derivative financial instruments include futures, forwards, swaps and options in the interest rate and foreign exchange markets. The Group manages and controls the market risk within its trading portfolios through limit structures of both a VaR and non-VaR nature. Non-VaR based constraints relate, inter alia, to positions, volumes, concentrations, allowable losses and maturities.

5.2 VaR model

A key element in the Group's market risk management framework is the estimation of potential future losses that may arise from adverse market movements. Exposure to general market risk is calculated utilising a VaR model. The use of the internal model approach for the calculation of the capital requirement for general market risk has been approved by the CBB. The multiplication factor to be applied to the VaR calculated by the internal model has been set at the regulatory minimum of 3.0 by the CBB.

An inherent limitation of VaR is that past market movements may not provide an accurate prediction of future market losses. Historic analyses of market movements have shown that extreme market movements (i.e. beyond the 99 per cent confidence level) occur more frequently than VaR models predict. Stress tests are therefore regularly conducted to estimate the potential economic losses in such abnormal markets. Stress testing combined with VaR provides a more comprehensive picture of market risk. The Group regularly performs stress tests that are constructed around changes in market rates and prices resulting from pre-defined market stress scenarios, including both historical and hypothetical market events. Historical scenarios include the 1997 Asian crisis, the 1998 Russian crisis, the events of 9/11 and the 2008 credit crisis. In addition, the Group performs stress testing based on internally developed hypothetical market stress scenarios. Stress testing is performed for all material market risk portfolios.

From April 2012, the CBB has required that the VaR used for regulatory capital adequacy purposes incorporate a stressed VaR measure. This measure is intended to replicate the VaR for the Group's market risk exposures during periods of stress. The stressed VaR is increased by the multiplication factor and then added to the actual VaR to determine the regulatory capital requirement for market risk.

A key objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability repricing profile based on anticipated movements in interest rates. VaR-based limits are utilised to manage the risk associated with fluctuations in interest earnings resulting from changes in interest rates. The asset and liability repricing profile of the various asset and liability categories is set out in section 8.2(c) of this report.

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

Risk management and capital adequacy report (continued)

31st December 2014

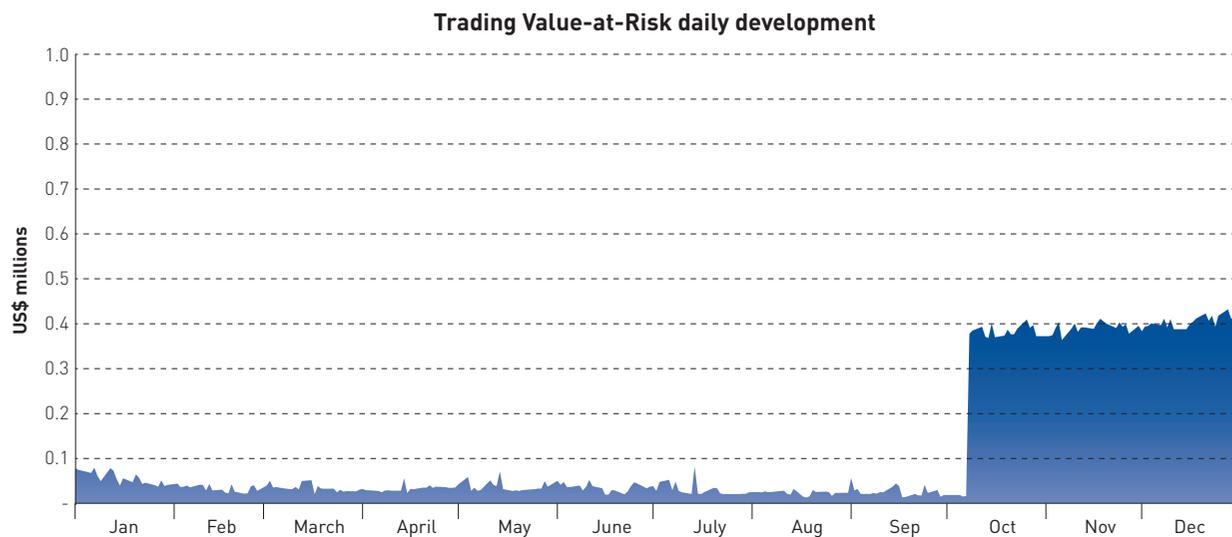
5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)

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

	31.12.14 US\$ millions	Average US\$ millions	High US\$ millions	Low US\$ millions
Total VaR	0.4	0.1	0.4	-
Total undiversified stressed VaR	0.6	0.3	1.5	0.1

The graph below sets out the total VaR for all the Group's trading activities at the close of each business day throughout the year ended 31st December 2014:-



The increase in the total VaR in October 2014 was attributable to equities acquired in relation to investment banking activities undertaken by the Group. The equities were held with the intention of selling in the near future.

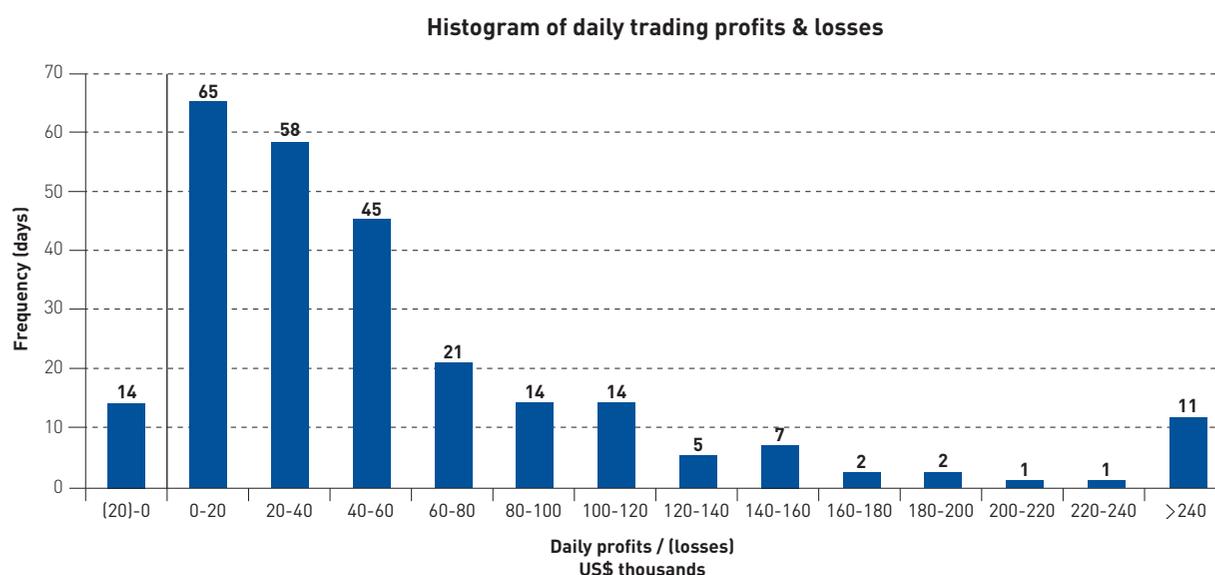
Risk management and capital adequacy report (continued)

31st December 2014

5. Market risk – Pillar 3 disclosures (continued)

5.2 VaR model (continued)

The daily trading profits and losses during the year ended 31st December 2014 are summarised as follows:-



The Group conducts daily VaR back testing both for regulatory compliance purposes and for the internal evaluation of VaR against actual trading profits and losses. During the year ended 31st December 2014, there were no instances of a daily trading loss exceeding the trading VaR at the close of business on the previous business day.

The five largest daily trading losses during the year ended 31st December 2014 compared to the 1-day VaR at the close of business on the previous business day were as follows:-

	Daily trading losses US\$ thousands	1-day VaR US\$ thousands
3 rd October	7	5
5 th December	6	143
9 th May	5	10
10 th October	5	125
24 th January	3	14

5.3 Sensitivity analysis

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

The Group's investment debt securities are measured at amortised cost. However, the Group nevertheless monitors the impact of changes in credit spreads on the fair value of the debt securities.

Risk management and capital adequacy report (continued)

31st December 2014

6. Operational risk – Pillar 3 disclosures

6.1 Operational risk

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

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

The capital requirement for operational risk is calculated for regulatory purposes according to the standardised approach, in which the regulatory capital requirement is calculated based on a range of beta coefficients, ranging from 12 to 18 per cent, applied to the average gross income for the preceding three financial years for each of eight predefined business lines. Consequently, the operational risk capital requirement is updated only on an annual basis.

7. Off-balance sheet exposure and securitisations

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

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

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

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

7.1 Credit-related contingent items

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

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

Risk management and capital adequacy report (continued)

31st December 2014

7. Off-balance sheet exposure and securitisations (continued)

7.1 Credit-related contingent items (continued)

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

	Notional principal amount	RWA	Capital requirement
	US\$ millions	US\$ millions	US\$ millions
Direct credit substitutes	528.3	470.5	56.5
Transaction-related contingent items	2,058.2	798.3	95.8
Short-term self-liquidating trade-related contingent items	498.4	75.0	9.0
Commitments	891.1	373.3	44.8
	3,976.0	1,717.1	206.1

Commitments include undrawn loan commitments and underwriting commitments under note issuance and revolving facilities, and may be drawdown on demand.

The notional principal amounts reported above are stated gross before applying credit risk mitigants, such as cash collateral, guarantees and counter-indemnities. At 31st December 2014, the Group held cash collateral, guarantees, counter-indemnities or other high quality collateral in relation to credit-related contingent items amounting to US\$526.9 million.

7.2 Derivative and foreign exchange instruments

The Group utilises derivative and foreign exchange instruments to meet the needs of its customers, to generate trading revenues and as part of its asset and liability management activity to hedge its own exposure to market risk. Derivative and foreign exchange instruments are subject to the same types of credit and market risk as other financial instruments. The Group has appropriate and comprehensive Board-approved policies and procedures for the control of exposure to both credit and market risk from its derivative and foreign exchange activities.

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

7. Off-balance sheet exposure and securitisations (continued)

7.2 Derivative and foreign exchange instruments (continued)

The aggregate notional amounts for derivative and foreign exchange instruments at 31st December 2014 were as follows:-

	Trading US\$ millions	Hedging US\$ millions	Total US\$ millions
Foreign exchange contracts:-			
Unmatured spot, forward and futures contracts	3,912.4	3,341.4	7,253.8
Options purchased	1,908.4	-	1,908.4
Options written	1,908.4	-	1,908.4
	7,729.2	3,341.4	11,070.6
Interest rate contracts:-			
Interest rate swaps	952.2	10,732.9	11,685.1
Cross currency swaps	-	533.3	533.3
Options, caps and floors purchased	12.4	-	12.4
Options, caps and floors written	12.4	-	12.4
	977.0	11,266.2	12,243.2
Commodity contracts:-			
Options and swaps purchased	16.2	-	16.2
Options and swaps written	16.2	-	16.2
	32.4	-	32.4
	8,738.6	14,607.6	23,346.2

7.3 Counterparty credit risk

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

a) Counterparty credit risk calculation

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

Risk management and capital adequacy report (continued)

31st December 2014

7. Off-balance sheet exposure and securitisations (continued)

7.3 Counterparty credit risk (continued)

a) Counterparty credit risk calculation (continued)

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

	Exposure at Default (EAD)			RWA US\$ millions	Capital requirement US\$ millions
	Current exposure US\$ millions	Future exposure US\$ millions	Total exposure US\$ millions		
Banks	115.9	111.8	227.7	54.3	6.5
Governments	65.3	36.9	102.2	-	-
Corporates	58.2	28.5	86.7	82.8	9.9
	239.4	177.2	416.6	137.1	16.4

b) Mitigation of counterparty credit risk exposure

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

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

	Current exposure US\$ millions	Effect of netting agreements US\$ millions	Netted current exposure US\$ millions
Counterparty credit risk exposure	239.4	(17.8)	221.6

7.4 Securitisations

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

At 31st December 2014, the Group had no exposure to securitisation tranches.

The Group provides collateral management services to five collateralised debt obligations (CDOs) issued between 2002 and 2006. The CDOs are intended to extract relative value from a wide range of asset classes across a broad spectrum of credit ratings. The underlying collateral of the CDOs includes leveraged loans, residential and commercial real estate, consumer finance, lending to small and medium sized enterprises, and other receivables. Each CDO holds up to 55 individual investments.

At 31st December 2014 the underlying investments in the CDOs for which the Group acted as collateral manager amounted to US\$0.6 billion. At 31st December 2014, GIB did not hold any exposure to CDOs managed by the Group.

Risk management and capital adequacy report (continued)

31st December 2014

8. Internal capital including other risk types

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

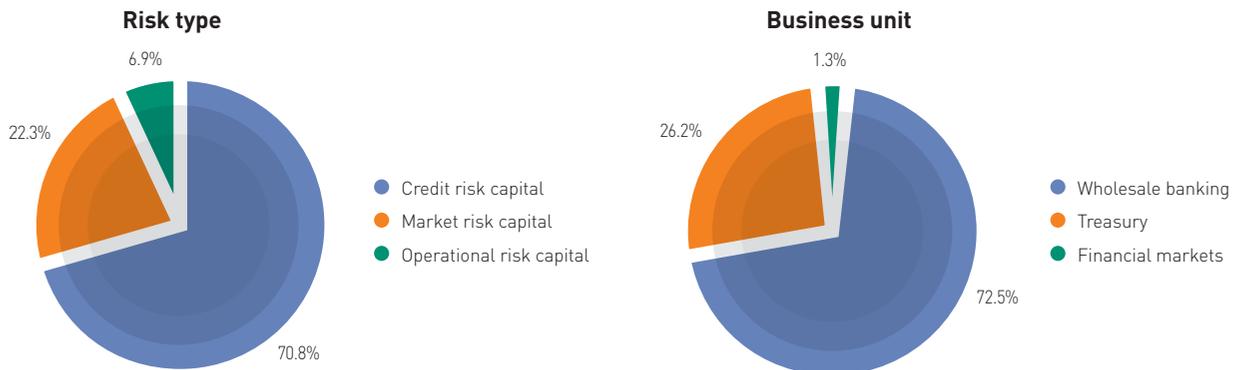
This section describes GIB's economic capital model and discusses the treatment of the other risk types that are not addressed in Pillar 1 of the CBB's Basel 2 framework.

8.1 Economic capital model

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

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

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



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

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

Internal rating system

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

Risk management and capital adequacy report (continued)

31st December 2014

8. Internal capital including other risk types (continued)

8.1 Economic capital model (continued)

Internal rating system (continued)

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

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

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

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

Risk management and capital adequacy report (continued)

31st December 2014

8. Internal capital including other risk types (continued)

8.2 Other risk types

a) Liquidity risk

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

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

The funding base is enhanced through term financing, amounting to US\$3,850.7 million at 31st December 2014. Access to available but uncommitted short-term funding from the Group's established Middle East and international relationships provides additional comfort. In addition to the stable funding base, the Group maintains a stock of liquid and marketable securities that can be readily sold or repurchased.

Contractual standby facilities are available to the Group, providing access to US\$500.0 million of collateralised funding based on pre-determined terms. The facilities are available to be drawn, in full or in part, at the Group's discretion up to 23rd February 2015.

At 31st December 2014, 67.6 per cent of total assets were contracted to mature within one year. With regard to deposits, retention records demonstrate that there is considerable divergence between their contractual and effective maturities.

US\$9,856.0 million or 69.7 per cent of the Group's deposits at 31st December 2014 were from GCC countries. Historical experience has shown that GIB's deposits from counterparties in the GCC region are more stable than deposits derived from the international interbank market. At 31st December 2014, placements and other liquid assets with counterparties in non-GCC countries were 1.2 times the deposits received, demonstrating that the Group is a net lender of funds in the international interbank market.

b) Concentration risk

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

Under the CBB's single obligor regulations, banks incorporated in Bahrain are required to obtain the CBB's approval for any planned exposure to a single counterparty, or group of connected counterparties, exceeding 15 per cent of the regulatory capital base. At 31st December 2014, the Group did not have any single obligor exposures exceeding 15 per cent of the Group's regulatory capital base (i.e. exceeding US\$376.5 million).

c) Interest rate risk in the banking book

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

Risk management and capital adequacy report (continued)

31st December 2014

8. Internal capital including other risk types (continued)

8.2 Other risk types (continued)

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

The repricing profile of the Group's assets and liabilities, including the trading book, are set out in the table below:-

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions
Cash and other liquid assets	2,300.1	172.5	-	-	-	2,472.6
Securities purchased under agreements to resell	1,257.8	47.4	-	-	-	1,305.2
Placements	5,163.4	17.1	-	-	-	5,180.5
Trading securities	-	-	-	-	72.7	72.7
Investment securities:-						
- Fixed rate	-	188.1	155.9	1,202.3	-	1,546.3
- Floating rate	1,545.8	548.0	-	-	(3.2)	2,090.6
- Equities	-	-	-	-	307.6	307.6
Loans and advances	6,139.0	1,839.9	100.6	-	(148.0)	7,931.5
Other assets	-	-	-	-	393.2	393.2
Total assets	16,406.1	2,813.0	256.5	1,202.3	622.3	21,300.2
Deposits	13,362.9	771.9	3.1	-	-	14,137.9
Securities sold under agreements to repurchase	550.1	67.9	-	-	-	618.0
Other liabilities	-	-	-	-	342.9	342.9
Term financing	3,190.0	660.7	-	-	-	3,850.7
Equity	-	-	-	-	2,350.7	2,350.7
Total liabilities & equity	17,103.0	1,500.5	3.1	-	2,693.6	21,300.2
Interest rate sensitivity gap	(696.9)	1,312.5	253.4	1,202.3	(2,071.3)	-
Cumulative interest rate sensitivity gap	(696.9)	615.6	869.0	2,071.3	-	-

The repricing profile is based on the remaining period to the next interest repricing date. Derivative financial instruments that have been used for asset and liability management purposes to hedge exposure to interest rate risk are incorporated in the repricing profiles of the related hedged assets and liabilities. The non-specific investment security and loan provisions are classified in non-interest bearing items.

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

Interest rate exposure beyond one year amounted to only US\$1,202.3 million or 5.6 per cent of total assets. This exposure principally represented the investment of the net free capital funds in fixed rate government securities. At 31st December 2014, the modified duration of these fixed rate government securities was 2.56. Modified duration represents the approximate percentage change in the portfolio value resulting from a 100 basis point change in yield. More precisely in dollar terms, the price value of a basis point of the fixed rate securities was US\$311,000.

Risk management and capital adequacy report (continued)

31st December 2014

8. Internal capital including other risk types (continued)

8.2 Other risk types (continued)

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

Based on the repricing profile at 31st December 2014, and assuming that the financial assets and liabilities were to remain until maturity or settlement with no action taken by the Group to alter the interest rate risk exposure, an immediate and sustained one per cent (100 basis points) increase in interest rates across all maturities would result in an increase in net income before tax for the following year and in the Group's equity by approximately US\$0.9 million and US\$0.5 million respectively. The impact on the Group's equity represents the cumulative effect of the increase in interest rates over the entire duration of the mismatches in the repricing profile of the interest rate sensitive financial assets and liabilities.

d) Foreign exchange risk

The Group does not maintain material foreign currency exposures. In general, the Group's policy is to match assets and liabilities in the same currency or to mitigate currency risk through the use of currency swaps.

e) Business risk

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

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

9. Capital adequacy ratios and other issues

9.1 Capital adequacy ratios

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

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

	GIBUK	Group
Total RWAs (US\$ millions)	1,057.0	12,782.1
Capital base (US\$ millions)	271.0	2,510.1
Tier 1 capital (US\$ millions)	271.0	2,311.0
Total ratio (per cent)	25.6	19.6
Tier 1 ratio (per cent)	25.6	18.1

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

Risk management and capital adequacy report (continued)

31st December 2014

9. Capital adequacy ratios and other issues (continued)

9.1 Capital adequacy ratios (continued)

Strategies and methods for maintaining a strong capital adequacy ratio

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

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

9.2 ICAAP considerations

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

GIB's regulatory capital base exceeded the CBB's minimum requirement of 12 per cent throughout the year ended 31st December 2014. Based on the results of capital adequacy stress testing and capital forecasting, GIB considers that the buffers held for regulatory capital adequacy purposes are sufficient and that GIB's internal minimum capital targets of 8 per cent for tier 1 capital and 12 per cent for total capital are adequate given its current risk profile and capital position. The Group's regulatory capital adequacy ratios set out in section 9.1 of this report significantly exceeded the minimum capital targets and are high by international comparison.

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

Risk management and capital adequacy report (continued)

31st December 2014

10. Glossary of abbreviations

ALCO	Assets and Liabilities Committee
AMA	Advanced Measurement Approach
Basel Committee	Basel Committee for Banking Supervision
CBB	Central Bank of Bahrain
CCF	Credit Conversion Factor
CDO	Collateralised Debt Obligation
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CRO	Chief Risk Officer
EAD	Exposure at Default
FCA	Financial Conduct Authority (of the United Kingdom)
FIRB Approach	Foundation Internal Ratings Based Approach
FVTOCI	Fair Value through Other Comprehensive Income
GCC	Gulf Cooperation Council
GIB	Gulf International Bank B.S.C.
GIBUK	Gulf International Bank (U.K.) Limited
The Group	Gulf International Bank B.S.C. and subsidiaries
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
LGD	Loss Given Default
MENA	Middle East and North Africa
ORMF	Operational Risk Management Framework
OTC	Over-The-Counter
PD	Probability of Default
PRA	Prudential Regulation Authority (of the United Kingdom)
PSE	Public Sector Entity
RAROC	Risk-adjusted Return on Capital
RWA	Risk-weighted Amount
VaR	Value-at-Risk

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