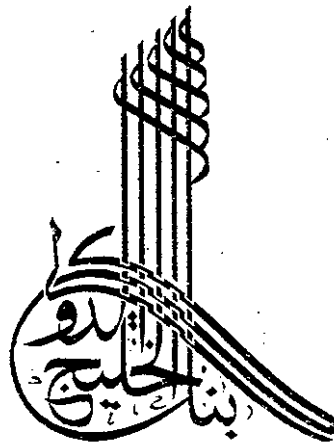


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Gulf International Bank B.S.C.

Annual Report and Accounts

1997



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Board of Directors

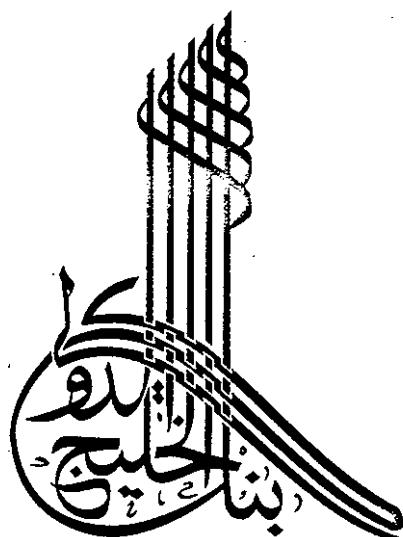
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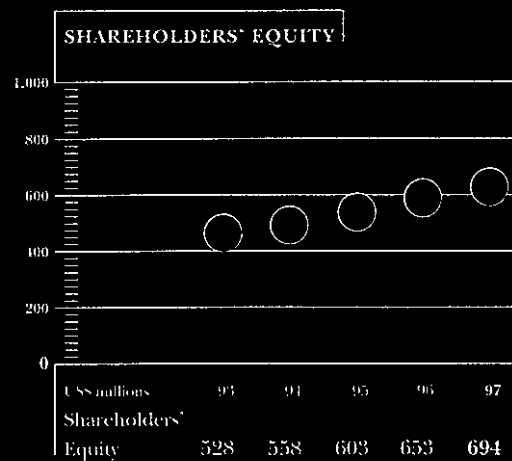
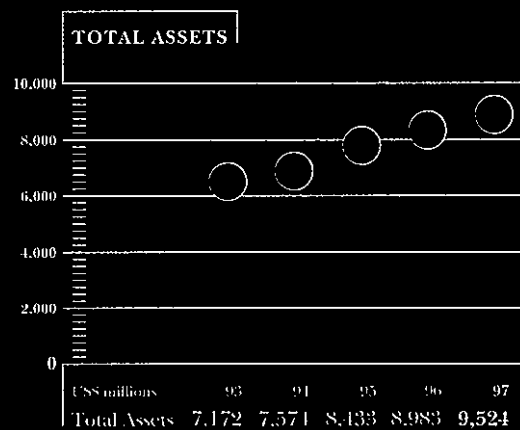
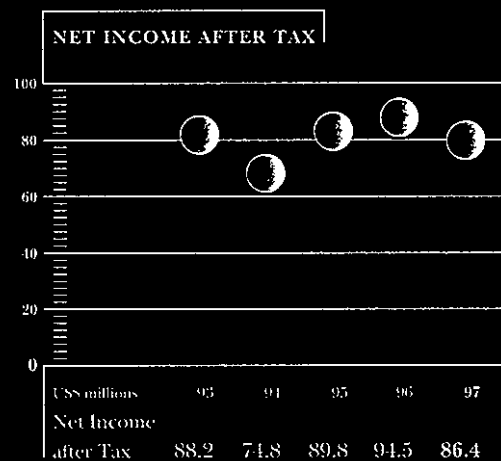
Corporate Directory



Gulf International Bank is a wholesale commercial bank based in Bahrain. It is wholly owned by Gulf Investment Corporation (GIC), the international investment banking corporation owned equally by the governments of the six member states of the Gulf Cooperation Council (GCC) – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates. The Bank's primary business focus is on the GCC market and the associated trade and financial flows between this area and the industrialised world.

Target clients include major indigenous private-sector corporations, Gulf-based financial institutions, multinational companies active in the region and the governments of the GCC states themselves. Branches in London and New York and representative offices in Singapore, Abu Dhabi and Beirut assist in servicing this client base. GCC market knowledge, expertise in its industries, extensive product skills, international reach and a commitment to excellence are distinguishing features of the bank.

Financial Highlights



Financial Highlights

	1997	1996	1995
EARNINGS (US\$ millions)			
Net Income after Tax	86.4	94.5	89.8
Net Interest Revenue	109.6	110.3	106.8
Other Income	54.0	38.8	33.3
Operating Expenses	46.7	44.3	42.7
FINANCIAL POSITION (US\$ millions)			
Total Assets	9,523.9	8,982.9	8,433.3
Loans	3,478.7	3,436.5	3,258.4
Trading Securities	192.1	86.2	134.6
Investment Securities	3,047.0	2,817.6	2,386.1
Shareholders' Equity	693.9	652.5	603.0
RATIOS (%)			
<i>Profitability</i>			
Return on Shareholders' Equity	12.5	14.5	14.9
Return on Assets	0.9	1.1	1.1
<i>Capital</i>			
BIS Risk Asset Ratio			
- Total	12.0	11.7	11.5
- Tier 1	10.7	10.4	10.3
Shareholders' Equity as % of Total Assets	7.3	7.3	7.2
Loans as a multiple of Equity (times)	5.0	5.3	5.4
<i>Asset Quality</i>			
Loans as % of Total Assets	36.5	38.3	38.6
Securities as % of Total Assets	34.0	32.3	29.9
GCC Country Risk as % of Total Assets	25.8	25.2	28.1
GCC & OECD Country Risk as % of Total Assets	84.4	83.8	84.6
<i>Liquidity</i>			
Liquid Assets Ratio	61.6	60.2	59.4
Deposits* to Loans Cover (times)	2.3	2.2	2.2
LONG-TERM DEBT RATINGS			
BankWatch	A-	A-	-
Moody's	Baa2	Baa2	-
Standard & Poor's	BBB+	BBB+	-

*Includes Term Financing

Board of Directors

H. E. IBRAHIM ABDUL-KARIM

Chairman

Minister of Finance & National Economy,
State of Bahrain

DR. KHALED AL-FAYEZ

Vice Chairman

Chief Executive Officer,
Gulf Investment Corporation, State of Kuwait

BADER ABDULLAH AL-RUSHAID AL-BADER *

Chairman & Managing Director,
Kuwait Investment Company, State of Kuwait

SAKER DHAHER AL-MORAIKHI

Director of General Financial Affairs,
Ministry of Finance, Economy & Commerce,
State of Qatar

HISHAM ABDUL RAZZAK RAZZUQI *

General Manager,
Gulf Investment Corporation,
State of Kuwait

SALEH ABDULLAH ALNAIM

Director General,
Saudi Industrial Development Fund,
Kingdom of Saudi Arabia

HUSSAIN BIN MOHAMMED HASSAN AL SALEH *

Director General of Financial Planning,
Ministry of Finance, Sultanate of Oman

MOHAMMED BIN SAIF AL SHAMSI

Head of Development Institutions,
Ministry of Finance & Industry,
United Arab Emirates

RASHID ISMAIL AL-MEER *

Assistant Under-Secretary for Financial Affairs,
Ministry of Finance & National Economy,
State of Bahrain

* Audit Committee Members

GIB is recognised for its *strong* capitalisation and sound asset quality.



Chairman's Statement

On behalf of the Board of Directors, I am pleased to present the twenty-first annual report of Gulf International Bank (GIB) for the financial year ended 31st December 1997. Steady growth in the Bank's core business activities continued during the year with the result that GIB has again achieved healthy profits. The Bank's consistently good financial performance, together with its focus on taking a lead role in arranging finance for both private sector and government projects are significant contributors to its position as one of the Middle East's primary financial institutions. GIB's future potential is further strengthened by the decision of the GCC's Supreme Council permitting the Bank to open branches throughout the GCC states.

In 1997 the Bank generated a record operating result before provisions of \$116.4 million, representing an 11.4 per cent increase over the prior year. In accordance with GIB's conservative and prudent provisioning policy, provisions for credit losses have been enhanced to cover any possible risks relating to exposures in South East Asia. Net Income, after allocation of \$30.0 million to credit provisions, was \$86.4 million, representing a 12.5 per cent return on Shareholders' Equity. On the basis of these commendable results, the Board proposes maintaining the dividend at 10 per cent of the paid-up share capital of \$450.0 million.

Total Assets advanced by \$541.0 million or 6.0 per cent to \$9,523.9 million at the 1997 year end with increases recorded in both the loan and investment security portfolios.

Throughout 1997, which overall was characterised by firm oil prices and a highly liquid world economy, the Bank has successfully strengthened its leading position in the GCC states. Core business activities continue to



be linked with the main economic activities of the region itself. Accordingly, the Bank's primary focuses are on lending to public bodies and private sector institutions, medium-term industrial project finance, asset-backed finance, international trade finance and treasury operations. In this respect, healthy levels of economic growth in the region have engendered substantial new project activity and attracted positive attention among the broader international financial community of which the Bank has been able to take the fullest advantage. The Bank has continued to take measures building and strengthening relationships with clients and counter-

Chairman's Statement

continued

parties with a view to consolidating existing areas of expertise as well as furthering its ambitions for diversification. At the same time the Bank will benefit significantly from the fact that many clients, particularly the governments of the GCC states, are also looking to diversify their economic bases. The Bank also increased its commitment to the growing Islamic banking market in the Gulf, in accordance with its resolve to remain responsive to customer requirements.

GIB's focussed target market, its ability to quickly respond to client's needs and, in coordination with its parent GIC, its ability to offer more products and financing services places the Group in the forefront to capitalize on the increasingly complex role which financial institutions are expected to play in the future development of the area. The capital markets capability at GIC and GIB's ability to access those markets is one such example.

As a result of gaining permission from the GCC's Supreme Council to open branches in the GCC states, the Bank's competitive position has been strengthened by this clear sign of commitment from the GCC governments. In particular, GIB's ability to attract wholesale business from financial institutions based in the Gulf, from multinationals active in the Middle East and from GCC governments will be enhanced. The benefits of expansion will also enhance GIB's position as a preferred GCC banking counterparty for wholesale transactions originating with financial institutions based outside the Middle East. In addition, expansion will reinforce the Bank's capacity to provide project finance in the region.

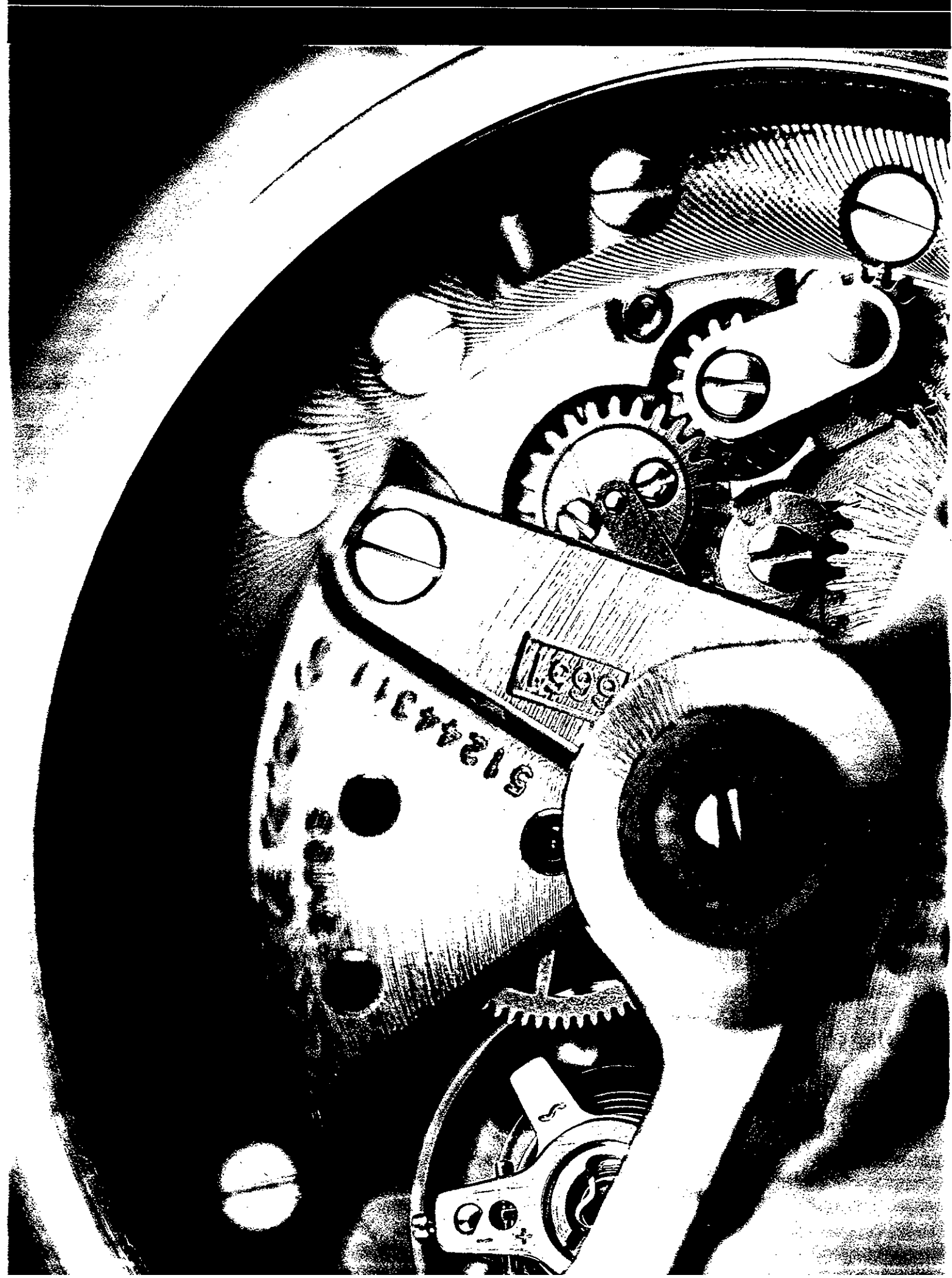
Acknowledgement of GIB's growing stature is demonstrated in the favourable comments and ratings of international rating agencies. The Bank's strong business franchise within the GCC and its continued success in converting large project and corporate finance opportunities in the region lie at the foundation of their assessments. Asset quality, capitalisation and profitability are also key factors in their assignment of investment grade ratings. Along with enhanced risk management systems and a newly created Risk Committee (created to monitor and enforce the whole of the Bank's risk profile) these are vital elements in the institution's ongoing well-being. In 1997 the Bank was also awarded the title "Best Bank in Bahrain" by Euromoney Magazine.

The impressive progress made by the Bank in so many important areas and its prominent position in its core markets is attributable to the outstanding efforts and expertise of GIB's management and its staff. I extend my thanks both to them and to my fellow Board members for their valued support. GIB will continue to reciprocate by supporting its people, and ultimately its clients and correspondents, through the provision of appropriate training of the highest quality and upgrades to technology. We look forward with enthusiasm and confidence to achieving our future objectives.



Ibrahim Abdul-Karim
Chairman

GIB's cohesive *teamwork* ensures a responsive, timely service combined with creative workable adv



Management Review

In the twelve months to year-end 1997, Gulf International Bank (GIB) once again achieved excellent results. Robust profitability reflects the continued strength of the Bank's competitive edge, reputation, acknowledged expertise and strategic business focus. GIB's ongoing commitment to tight risk management fully supports its position as a market leader in the Gulf. With its long history of successful, high profile involvement in government projects and a substantial growing number of private sector projects, GIB remains ideally placed to take full advantage of the opportunities arising from significant investment in a variety of projects throughout the Gulf and elsewhere.

Expansion and excess liquidity characterised world economies throughout much of 1997 with most areas showing continued growth, albeit at a slower pace than previously. The associated demand for oil also continued to grow, contributing positively to an improved economic performance in the Gulf, which has both large oil reserves and a high installed capacity to access those reserves. Oil producers in the region experienced surpluses. At the same time, the region's stock markets rose significantly, all six GCC states posted lower budget deficits than in 1996, oil prices remained firm throughout the year and currencies in the GCC states successfully maintained their stability against the US dollar. There was some lowering in expected demand for oil as events in South East Asia gathered momentum towards the end of the second half. Nevertheless, prospects for the Gulf oil industry remain good and the region can expect to benefit well into the early years of the new millennium.

Governments around the region have again shown

a high degree of fiscal discipline, a substantial drive towards improving administrative efficiency and continued commitment to encouraging private sector funding for a broad range of major sectors. This includes next-phase development in oil, gas, heavy industry and infrastructure schemes and is consistent with the recognised desirability of increasing diversification into areas other than oil. Activity levels and consumer confidence remained high, attracting additional international players to the region.

The Bank maintains a strong commitment to pursuing wide ranging strategies that enhance the quality of its products and services. It will continue to build on its undoubted strengths and promote its reputation as the region's lead banker of choice with world-level expertise to support its core wholesale banking businesses in medium-term industrial project finance, corporate lending, asset-backed finance, Islamic banking services, international trade finance and treasury services.

Management Review

continued

Economic buoyancy in the GCC and other Arab countries, together with the project and trade activity engendered by such favourable conditions, will continue to attract newcomers to the area. GIB's unique understanding of the area and its financing requirements, combined with its own ability to identify outstanding opportunities and develop close relationships with top-tier clients, ensure that the Bank's leading position is securely underpinned.

As local governments push forward with strategies designed to strengthen their economies through diversification aimed at supporting a sustainable move away from dependence on oil, GIB is able to strengthen its business base. Closer coordination with GIC will also enable the two institutions to offer clients and potential clients a widening range of complex services for the future development of the GCC states. It is expected that there will be particular emphasis on joint activity in supplying customer requirements in capital markets as their borrowing practices develop and diversify.

The Bank's ability to maintain effective risk management strategies has again been crucial to its increased success. As ever, its stance throughout the year was one of prudence based on sound evaluation and monitoring. This approach forms one of the cornerstones of the excellent ratings afforded to the Bank by the international rating agencies, Standard & Poor's, Moody's and BankWatch. Added to the extensive regional expertise of the specialist teams, the Bank has successfully increased its knowledge and skills in the US, European and Asian markets. The strong ties with GIC have again provided further support.

The Bank's reputation has been further highlighted and enhanced following the GCC Supreme Council's decision permitting GIB to open branches in the six member states. Moves such as this, clearly signalling continued high levels of government confidence in the

Bank, serve to complement the confidence already demonstrated by regional and international financial institutions. This broader manifestation of confidence in turn reinforces the trust placed in the Bank by its many clients with whom it has developed close and supportive professional relationships. Consequently, it is anticipated that more and more clients will seek to extend the nature of the requirements which the Bank is chosen to supply. As the GCC states continue their drive towards increased privatisation, new opportunities will inevitably arise.

*Working with clients
to provide innovative and
appropriately packaged
financial services to
satisfy their needs.*

PROJECT FINANCE

GIB has again succeeded in consolidating its position as a major player in the syndicated financing of a wide range of prominent projects around the region. Sentiment surrounding such projects has been extremely positive among international invest-

ment bankers, who have participated on a vast scale in privately-funded, major infrastructure programmes. During the year, the Bank has played a salient role in every syndicated transaction involving the participation of GCC banks, in line with its ongoing strategy and by working with clients to provide innovative and appropriately packaged loans to secure these deals.

GIB experienced a markedly buoyant year in its home markets and completed more than ten major project finance transactions in 1997. From a total of almost seventy transactions to which the Bank was party, a syndication agreement in Oman proved to be one of the largest commercial loans undertaken in the Middle East. During the year, GIB was also the lead banker in a syndicated financing arrangement that provided a uniquely structured 10-year loan of \$500 million to SCECO-East, a Saudi Arabian utility, for the construction of the Ghazlan power station. Another sizeable and prestigious deal concerned the

Management Review

continued

commercial financing of a Saudi petrochemical project for Saudi Chevron Petrochemical Company's aromatics plant located in Jubail. The first completely private industrial petrochemical project, it was also the first in the Gulf to be funded on a limited recourse basis. Year-end was notable for two valuable contracts with Air Finance Corporation Ltd, a government owned company, for the purchase of aircraft by Saudia Airlines the national flag carrier and the Jorf Lasfar Energy Corporation a "ground breaking" independent power project in Morocco.

GIB has an equally significant wealth of understanding and expertise in power, oil and gas. The continuing focus on close monitoring of the Bank's portfolio was a key element in the year's success, supporting lending decisions and avoiding over-concentration in geographical or sectoral zones and ensuring that the minimisation of risk remained a central theme across the board. This approach produces a sound basis for business and the Bank's relationships with local and regional banks remains productive and complementary.

At a wider international level the professionalism of GIB's expert teams and their exceptional delivery standards have been crucial to the enhancement of the Bank's position as the preferred counterparty for leading international financial institutions. It will therefore continue to build on these relationships and on the extensive established and nascent relationships developed with many of the world's major industrial corporations and Export Credit Agencies.

GIB anticipates that the next decade will create further outstanding opportunities in project finance given World Bank estimates of the amount of investment required in infrastructure in GIB's natural markets. Likewise, hydrocarbon wealth in the Gulf, low-cost raw materials for petrochemical projects and identified requirements for finance in the Gulf

region's petrochemical and electricity sector can be expected to create extensive scope for GIB's proven and evolving skills.

TRADE FINANCE AND ISLAMIC BANKING

GIB's ability to develop profitable trade finance products is supplemented by its facility to structure tailor-made products for individual clients by drawing on expertise from the different specialisations within the Bank. Trade finance activities typically involve co-operation throughout GIB's international network and have been instrumental in consolidating the Bank's

position as the premier Arab Bank. Documentary credit confirmation and refinancing operations along with the capacity to issue suitable letters of credit were the main source of GIB's new and ongoing business and have continued to create opportunities with prime corporates

in the GCC market. The London branch made a valuable contribution to the Bank's trade finance book, not least in respect of facilitating export shipments of hydrocarbons from the GCC and other parts of the Arab world into Europe. Correspondent banking relationships in place with the key banking institutions also play an important role in the Bank's growth and standing.

GIB has increased the diversification of its Islamic banking offer through the provision of successful asset-backed project and trade finance deals. Wholesale non-interest bearing trade-related facilities remain the major focus. As a consequence, GIB has been able to attract substantial funds to non-interest bearing Islamic investment opportunities and it will continue to highlight the potential of international markets. With a view to the longer term, a certain amount of capacity during 1997 was targeted at identifying and converting more medium-term transactions, in accordance with clients' gradually changing needs.

GIB possesses a wealth of understanding and expertise in the major industries of the region, namely, power, oil, gas and petrochemicals.

Management Review

continued

TREASURY AND CAPITAL MARKETS

Treasury and Capital Markets at GIB report increased activity, volumes and profitability for 1997. The money market improved, interest income exceeded budget expectations and foreign exchange improved its performance over the previous year. Successful utilisation of GIB's treasury expertise was the main factor in achieving these results. The Bank was able to offer customers high-yielding off-balance sheet derivative and foreign exchange instruments, and hedge its risks to produce significant investment income from its involvement. At the same time, building volume in customer business remains the primary focus of activity ahead of market risk taking.

The effectiveness of GIB's risk management strategies and techniques in Treasury underpins the widespread international confidence placed in its operations which are independently acknowledged to be among the most sophisticated in the Gulf. Implementation of further improvements in back-office systems began in 1997 and the Bank expects to increase its lead over competitors in terms of ability to exploit the most up-to-date risk evaluation techniques with benefits to marketing, trading practices and management reporting.

As part of its commitment to diversification of risk and lengthening the maturity of its liabilities to increase protection against potential short-term liquidity, the Bank signed a \$200 million debut floating rate note in July. Arranged by Chase Manhattan International Limited and co-lead managed by Gulf Investment Corporation, the note was floated in the international capital markets with the intention of attracting non-traditional term investors and opening up a new pool of funds. It has already created high levels of demand. This success represents further substantial evidence of GIB's international standing and the quality of the issue itself. Asset quality

continues to be a key theme and a growing percentage of GIB's assets are invested in securities issued by European or US entities and rated A and above by international rating agencies. A large proportion of these securities are floating rate notes outside the GCC and are concentrated in G10 countries.

INTERNATIONAL NETWORK AND OPERATIONS

Based in Bahrain, GIB is supported internationally by branches in London and New York and by representative offices in Lebanon, United Arab Emirates (UAE) and Singapore.

Trade finance remained a major source of business for the London branch which was particularly active in facilitating hydrocarbon exports from the GCC and Middle East to Europe. It also played a significant support role to many GCC-based projects as well as expanding its

structured debt expertise; extended the average tenor of its liabilities and increased its counterparties for currency and money market activities. In addition to intensified coverage of the North African market London branch was able to increase its referral to the Islamic Banking Division in Bahrain. In New York, GIB maintained its commitment to business in the GCC. In addition, it was very active in the telecommunications, media and cable industries through its involvement in high-value transactions with varying levels of complexity for world-class clients. These included uniquely structured banking facilities for Time Warner Inc; credit facilities for WorldCom; letter of credit facilities for FLAG (Fibreoptic Link Around the Globe); vendor financing and bank facilities for Sprint Spectrum PCS; and structured financing for Global Telesystems Ltd.

Against an economic background that continued to strengthen along with Lebanon's reconstruction efforts, the Lebanon representative office enjoyed a

Transactions to satisfy customer needs remain the primary focus of the Bank's treasury activity.

Management Review

continued

particularly rewarding year enabling GIB to work more closely with its counterparties. Its co-operation with the Project Finance Division contributed to GIB's participation in a \$100 million syndicated facility for France Telecom Mobiles Liban. Strong links with other divisions of the Bank continue to provide and support a variety of new business. The Singapore representative office is geared towards conducting valuable market research in the region to support the Bank's activities, while activity in the UAE representative office has focused on developing relationships and business locally with a range of multinationals. During the year, GIB took the opportunity to make a satisfactory sale of its shareholding in its Omani associate, GIBCorp Oman.

TECHNOLOGY AND RISK MANAGEMENT

Commitment to quality operations and profitable business practices mean that GIB reviews its technology requirements regularly to help reinforce its lead position in the region with regard to banking, management and communications systems. Like many businesses around the world, GIB has instituted detailed programmes to eliminate exposure to the "Millennium Bug". The "Year 2000" project team conducted a comprehensive compliance review that

subsequently led to the development of a full action plan to eliminate any non-compliant units. Full testing will be completed during 1998 to ensure that GIB is Year 2000 compliant. The Bank is also gearing up its systems to be capable of dealing with introduction of the new Euro currency which is expected to be launched in 1999. The Bank will also be active in establishing compliance among customers, correspondents and counterparties.

The Bank remains committed to tight control and management throughout its businesses, with particular ongoing emphasis on cost control, risk management,

*A Risk Committee
was established during the
year with responsibility
to oversee the active
management of all risks.*

management information systems and global communications. A senior-level Risk Committee, chaired by the Group Chief Executive Officer, was established during the year, with responsibility for advising on and monitoring the Bank's overall risk strategies. GIB is regarded as having

a noteworthy commitment to career development for its employees and the provision of ongoing specialist training. This, together with a rigorous selection programme, is key to GIB's successful recruitment and retention of employees able to complement the skills of existing teams and contribute substantially to its future success in an increasingly competitive marketplace.

GIB has a clear strategic *focus* to provide its customers with access to international financial markets.

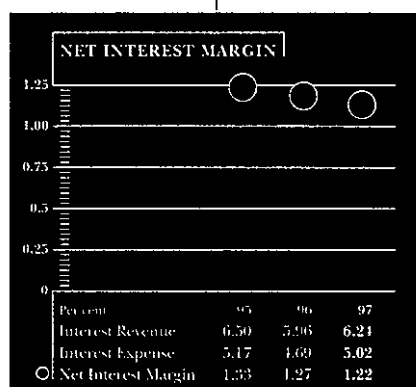
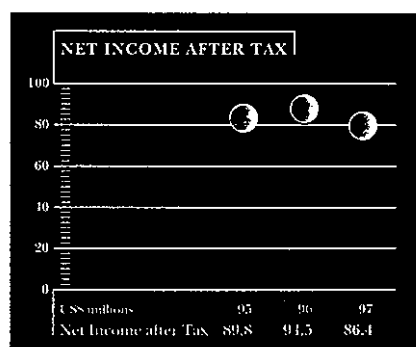


Financial Review

Net Income after Provisions and Tax was \$86.4 million for the year representing a 12.5 per cent return on Shareholders' Equity. At the operating level the Bank generated a record operating profit before provisions of \$116.4 million, representing an 11.4 per cent increase over the prior year pre-provision result. The year-on-year advance reflected strong performances in the Bank's core businesses and in particular solid earnings growth in its core commercial banking activity. Revenue growth was also achieved through an advance in non-interest earnings and the continued containment of operating expenses.

NET INTEREST REVENUE

Net Interest Revenue at \$109.6 million was marginally down on the prior year. A lower interest rate environment prevailed in most economies in 1997. The Bank was nevertheless able to sustain the level of interest earnings on the investment of its net free capital funds. As a result a higher amount of capital was available for investment. Improved interest earnings were recorded on the Bank's core commercial banking portfolio with improved margins combined with a higher average volume of performing loans. Money book earnings in 1997 were also up on the prior year with advantage being taken of lower interest rates to



minimise the overall cost of funding. In contrast, there was some margin contraction on the floating rate investment security portfolio as maturing assets were replaced at reduced margins. In addition, during the year under review the Bank increased, on a selective basis, investments in externally managed funds from which income is derived in the form of dividends and capital gains. The increased funding cost associated with the higher average volume of these non-interest bearing investments contributed to a decrease in the net interest margin, based on the average of opening and closing interest-bearing assets, to 1.22 per cent from 1.27 per cent in the prior year.

Financial Review

continued

OTHER INCOME

Other Income rose by 39.2 per cent to \$54.0 million. The increase was principally attributable to a significant \$10.2 million advance in Profits on Trading Securities and also to an \$8.6 million profit realised on the sale of the Bank's investment in an associated company, GIBCorp Oman LLC. The year-on-year increase in the Profit on Trading Securities was largely attributable to profits generated on externally managed funds. An analysis of Other Income with prior year comparatives is contained in Note 15 to the Financial Statements. Profit on Investment Securities of \$9.4 million represented realised profits on fixed income securities and profits on floating rate debt securities called back by the issuers. Dividend income of \$8.5 million was received from equity investments of a structured finance nature and from externally managed funds.

OPERATING EXPENSES

Operating Expenses at \$46.7 million were 5.4 per cent up on the prior year. Staff Expenses recorded a modest \$0.3 million rise to \$30.3 million. The effect of salary rises was largely offset through the containment of other compensation related expenses. Premises Expenses at \$4.3 million were much in line with the prior year while Other Expenses recorded a \$2.2 million advance against the prior year. This largely reflected higher depreciation expenses resulting from an ongoing enhancement of the Bank's computer systems.

CAPITAL STRENGTH

Shareholders' Equity rose by 6.3 per cent to \$693.9 million. This resulted from earnings retentions of \$41.4

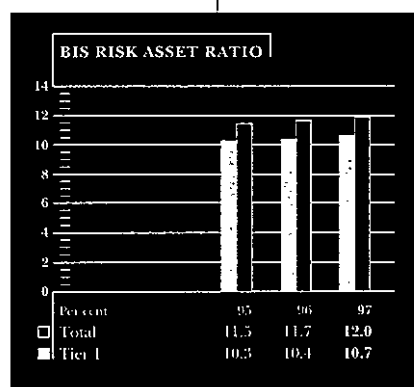
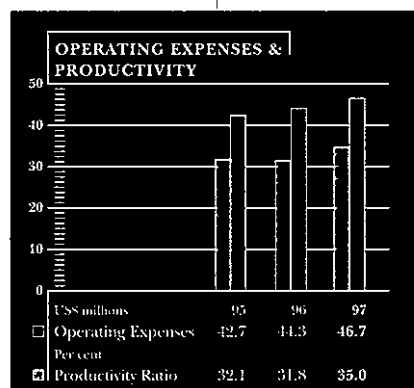
million after a 10.0 per cent Proposed Dividend of \$45.0 million. Shareholders' Equity and Tier 1 Capital both represented 7.3 per cent of Total Assets, ratios that are high by international comparison. The average Tier 1 capital to total assets ratio of the top 1,000 banks in 1997 was 4.6 per cent according to a survey published in The Banker in July 1997.

With a total capital base of \$774.8 million and total risk-weighted exposure of \$6,475.4 million the risk asset

ratio calculated according to the guidelines of the Basle Committee on Banking Supervision was 12.0 per cent. The risk asset ratio at the 1997 year end incorporates market risk-weighted exposure. Exposure to market risk has been calculated utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risk. The high proportion of Shareholders' Equity within the total capital base resulted in a Tier 1 ratio of 10.7 per cent. This ratio is particularly high by international standards. Note 22 to the Financial Statements provides further detail on capital adequacy. The risk asset ratio calculated in accordance with the guidelines of the Bank's regulatory authority, the Bahrain Monetary

Agency (BMA), was 12.7 per cent at the 1997 year end (1996: 12.3 per cent). Under the BMA guidelines GCC governments and government-owned entities are accorded the same preferential risk weighting as for OECD governments. With effect from 1st January 1998 the BMA has instituted a minimum risk asset ratio of 12 per cent compared to a minimum of 8 per cent prescribed by the Basle Committee.

Factors which contribute to the favourable capital adequacy position are the strong capital base, the level



Financial Review

continued

of general provisions and significant exposure to major OECD country governments and to the banking community. It is management's goal to maintain the strong capital adequacy position. The Bank utilises a range of risk management benchmarks against the capital base. For example, in terms of credit risk management, exposures by industry, customer and country are controlled against the capital base. Absolute and segmented loan volumes are also monitored against the equity base. At the 1997 year end Loans and Advances represented 5.0 times Shareholders' Equity compared to 5.3 times in 1996.

ASSET QUALITY

The Bank's principal strategic focus is on the GCC states and their major trading partners in the industrialised world. Geographical diversification of risk occurs to a large degree naturally as a result of the Bank's participation in these international relationships. In order to obtain an assessment of the geographic diversification of risk assets particular reference should be made to Note 18 to the Financial Statements. Further assessment of asset quality can be facilitated by reference to Note 25 to the Financial Statements on the fair value of financial instruments. Based on the valuation methodology set out in that note the net fair values of all on- and off-balance sheet financial instruments exceeded their net book values at 31st December 1997 by \$99.6 million.

At the 1997 year end Loans and Advances represented 36.5 per cent of Total Assets while Investment Securities accounted for 32.0 per cent.

Loans and Advances

Loans and Advances increased by \$42.2 million to \$3,478.7 million at the 1997 year end. Based on contractual maturities at the balance sheet date 53.0 per cent of the portfolio was due to mature within one year while 76.5 per cent was due to mature within three

years. Details of exposure within the portfolio to GCC and OECD country governments are contained in Note 7 to the Financial Statements while the geographic distribution of Loans and Advances is set out in Note 18 to the Financial Statements. 48.4 per cent of the portfolio represented lending within the GCC states while the balance was largely made up of exposure to the GCC countries' major trading partners in Europe, North America and Asia. The portfolio contained no significant concentrations by industrial sector. As discussed in Note 25 the net fair value of loans and advances exceeded their net book value by \$69.1 million.

Total loan loss provisions at 31st December 1997 amounted to \$789.6 million. Country and counterparty specific provisions amounted to \$615.5 million while general provisions were \$174.1 million. The loan loss provision charge for the year of \$23.0 million – which was in addition to a \$7.0 million charge in respect of investment securities as commented on in more detail in the following section of the review – comprised increases in the specific and general provisions of \$18.0 million and \$5.0 million respectively. The general provision at the year end represented 4.8 per cent of loans net of specific provisions.

Specific provisions in respect of troubled sovereign exposure are determined with reference to matrices of the relevant regulatory authorities. Specific provisions in respect of other loans are made to the full extent of the estimated potential loss while general provisions are maintained to cover possible future losses which as yet have not been identified. It is bank policy to write off loans after all reasonable restructuring and collection activities have taken place and the possibility of further recovery is considered to be remote.

The Bank adopted a prudent and conservative approach with respect to provisions against exposures which may be potentially impacted by the financial crisis witnessed in South East Asia in the latter part of 1997. Although no individual exposures were identified

Financial Review

continued

for which a specific provision was considered necessary, provisions for country risk were nevertheless enhanced in view of the generally uncertain financial climate in those South East Asian countries with economic adjustment programmes supported by the International Monetary Fund.

The gross and net book values of non-performing loans amounted to \$516.3 million and \$24.0 million respectively. As a result the gross volume of non-performing loans continued to be substantially below the total of specific and general provisions. This means that rather than the earnings on the Bank's net free capital funds being impaired, there is a positive earnings enhancement. Non-performing loans at their net book value of \$24.0 million represented just 0.7 per cent of net loans being at the same level as in 1996. Non-performing loans at their net book value also represented only 3.5 per cent of Shareholders' Equity. Loans on which interest or principal is 90 days or more overdue are without exception placed on a non-accrual basis and all unpaid and accrued interest is reversed from income. Interest on non-accrual loans is accounted for only when received.

Investment Securities

Investment Securities increased by \$229.4 million to \$3,047.0 million at 31st December 1997. The year-on-year increase largely reflects the growing preference of international institutions for raising finance through the capital markets rather than the traditional lending market. The investment securities portfolio is also used as a means of enhancing geographical diversification of the Bank's risk assets with well over three-quarters of the portfolio comprising securities of North American and European issuers.

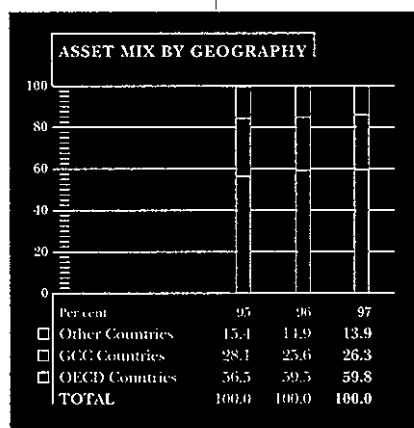
Investment Securities principally comprise two debt

security portfolios. The larger debt security portfolio comprises floating rate securities or fixed rate securities that have been swapped to floating to yield constant spreads over LIBOR. These account for three-quarters of the total investment portfolio. The smaller debt security portfolio is made up of OECD government fixed income securities. This represented the partial investment of the Bank's net free capital. At the 1997 year end approximately two-thirds of the fixed

income portfolio was invested on a currency hedged basis in the European government bond markets while the balance was invested in the US Treasury market.

An analysis of the investment securities portfolio is contained in Note 6 to the Financial Statements. \$858.8 million or 28.2 per cent of the portfolio at the 1997 year end represented AAA-rated securities.

Based on the rating of the issuer a further \$1,629.4 million or 53.5 per cent of the portfolio represented investment grade debt securities. Thus 81.7 per cent of the total portfolio comprised investment grade securities. Other Debt Securities at the end of 1997 amounted to \$349.5 million. These securities are largely of a loan substitution nature and as such are not necessarily rated. The credit risk associated with these securities is rigorously monitored within the overall credit risk management process. The securities are therefore subject to the same stringent credit requirements as standard lending and contingent transactions. Equities and Equity Funds at 31st December 1997 amounted to \$209.3 million. The equity and equity fund portfolio principally comprised equity investments in special purpose vehicles providing leveraged exposure to high quality debt securities. The portfolio also included a wide range of externally managed funds which provide a diversified exposure to equity, debt and real estate markets.



Financial Review

continued

Total investment securities provisions at 31st December 1997 amounted to \$37.6 million. Specific provisions, which comprise provisions in respect of both permanent diminutions in value and also troubled sovereign exposures as determined with reference to regulatory authority matrices, amounted to \$15.9 million while general provisions were \$21.7 million. The charge for the year of \$7.0 million comprised increases in the specific and general provisions of \$6.3 million and \$0.7 million respectively. At 31st December 1997 the market value of the investment security portfolio exceeded the book value by \$30.5 million.

Other Interest-bearing Asset Categories

Placements with Banks increased by 4.6 per cent to \$2,281.4 million and were well diversified by geography as illustrated in Note 18 to the Financial Statements. Placements with Asian counterparties almost entirely comprised placements with the larger Japanese city centre banks.

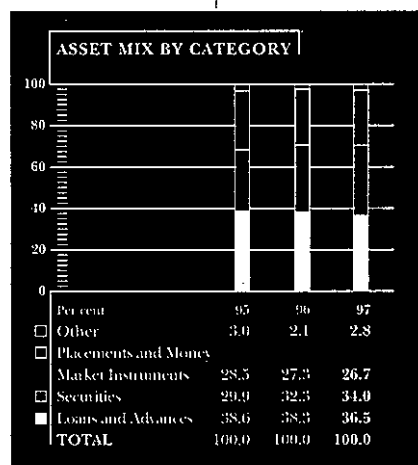
Money Market Instruments amounting to \$260.7 million principally comprised US and German government Treasury bills.

Trading Securities at \$192.1 million principally comprised listed debt securities. Trading Securities at the 1997 year end also included \$75.7 million of managed funds. The funds, which are managed by international institutions with acknowledged expertise in their field, provide diversified exposure to foreign exchange and international debt markets. Trading Securities are accounted for at market value.

Risk Asset and Commitment Exposure

Risk assets and commitments at 31st December 1997 amounted to \$12,518.4 million. Risk assets and commitments comprise all assets included in the

balance sheet (other than Fixed and Other Assets) and Credit-related Contingent Items. As alluded to earlier an analysis of risk asset and commitment exposure by category and geography is contained in Note 18 to the Financial Statements. An analysis of derivatives and foreign exchange products is set out in Note 21(a) while a further analysis of Credit-related Contingent Items together with their risk-weighted equivalents is contained in Note 21(b) to the Financial Statements.



CREDIT RATINGS

During the year under review the Bank's investment grade debt ratings were reaffirmed by Standard & Poor's, Moody's and BankWatch. Both Financial Strength and Global Issuer ratings are awarded on a scale from A to E. These two ratings are specific to Moody's and BankWatch respectively.

	BankWatch	Moody's	Standard & Poor's
Long-term	A-	Baa2	BBB+
Short-term	TBW-1	P3	A2
Financial Strength	-	C	-
Global Issuer	B/C	-	-

Standard & Poor's ratings reflect 'the bank's growing franchise in the Gulf region, its strong capitalisation, both at the bank level and shareholder level, and good financial performance'. According to BankWatch 'GIB is a well run bank with exceptional management reporting systems which enables proper enforcement of prudent lending, investing and asset and liability management policies' while Moody's financial strength rating 'is one of the highest assigned in the Gulf region and reflects the bank's strong franchise in the Gulf as well as its healthy financial fundamentals'. It is an objective of GIB to manage itself in such a manner as to retain and enhance the assigned ratings.

A dedication to *excellence* has given GIB a distinct competitive advantage.

EUROMONEY
AWARDS
FOR
EXCELLENCE
1997

Financial Review

continued

RISK MANAGEMENT

GIB maintains a prudent and professional approach to risk-taking. The Bank actively promotes a risk management culture that accords high value to disciplined and effective risk management and employs professionally qualified people with appropriate risk management skills. The Bank has instituted a comprehensive risk management process which effectively identifies, measures, monitors, and controls risk exposures and that is subject to oversight by senior management and the Board of Directors. GIB is also fully supportive of the risk management recommendations of the Basle Committee on Banking Supervision and the actions being taken by national supervisory authorities with respect to the application of appropriate and adequate risk management principles.

The Bank's risk management control process is based upon a detailed structure of policies, procedures and limits, a comprehensive risk measurement process and a strong management information system for the control, monitoring and reporting of risks. All significant policies are approved by the Board of Directors. Policies are consistent with corporate strategy, capital strength and management expertise. Both policies and procedures are reviewed regularly in order to ensure their continued appropriateness. Integrated bankwide limits are an essential component of the risk management process. This permits management to control exposures and to monitor the assumption of risk against predetermined approved tolerances. Global limits are established for each major type of

risk. These are generally sub-allocated to individual business units.

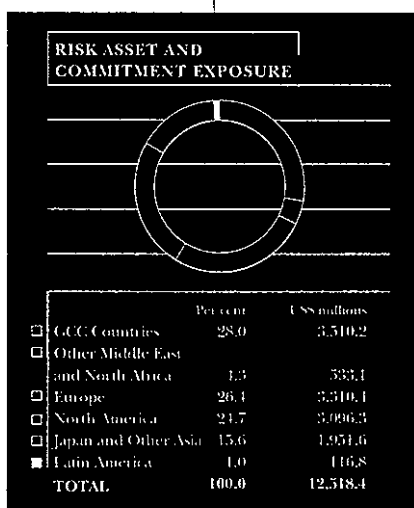
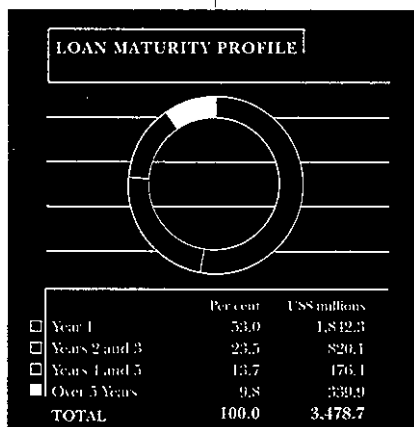
During the year under review the Bank established a Risk Committee under the chairmanship of the Group Chief Executive Officer with the responsibility to oversee the active management of all risks involved in the Bank's business. The Risk Committee is the senior authority within the integrated risk management hierarchy. The role of the committee includes

responsibility for the strategic management of the overall risk profile, ensuring the adequacy of the risk management infrastructure and coordination of the various specialist risk control areas. The Risk Committee provides a forum for discussion of risk issues by senior management personnel as well as ensuring that the Bank is aware of the latest developments in risk management practice within the financial services industry.

A market risk management unit within the financial controls function which possesses market risk management skills and is capable of informative interpretation of management information contributes positively to the overall effectiveness of the risk management process. The Bank ensures that all risks associated with a product or line of business are clearly understood and are monitored and reported to senior management

by professionally qualified and experienced personnel outside the business unit responsible for transacting that business.

A strong internal audit function is also of particular importance. The internal audit function conducts periodic reviews of the adequacy and integrity of the



Financial Review

continued

risk management process. Auditing procedures are designed to ensure the integrity of the measurement, control and reporting systems and compliance with approved policies and procedures. The Chief Auditor reports regularly to the Audit Committee of the Board of Directors. Recommendations from both the internal and external auditors are considered positively by senior management. In cases where remedial action is deemed appropriate, such action is undertaken promptly.

A fundamental risk management tenet within GIB is the clear segregation of duties and reporting lines between personnel transacting business and personnel processing that business. Key elements of the processing environment are clearly defined procedures, adequate systems infrastructure and a comprehensive system of internal controls.

The Asset and Liability Committee ("ALCO"), which comprises members of senior management, provides a forum for treasury risk management. ALCO meets on a weekly basis to review matters relating to both the asset and liability management function and trading strategies.

The Bank manages risks associated with off-balance sheet derivative instruments as part of its overall risk management function. Financial and risk management disclosures with respect to off-balance sheet financial instruments are set out in Note 21 to the Financial Statements. The disclosure provides details of derivative and foreign exchange transactions at 31st December 1997 analysed by type of product, counterparty and maturity.

The major risks of GIB are credit, market, liquidity and operational. These are discussed in more detail in the following sections.

Credit Risk

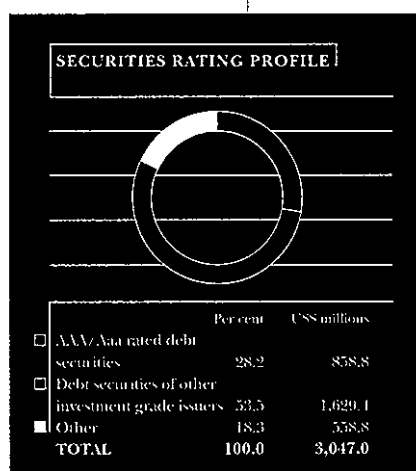
Credit risk represents the risk that a counterparty will fail to perform according to agreed terms and conditions, thus causing the bank to suffer a loss in terms of cash flow or market value. It measures this risk in relation to banking and treasury products both on and off the balance sheet.

Credit risk is actively managed and rigorously monitored in accordance with well-defined credit

policies and procedures. The credit-worthiness of each counterparty is assessed, and appropriate credit limits are established within delegated authority by the Credit Committee. Credit limits are also established for countries, utilising a country risk review system. Overall industry and product exposures are also evaluated to ensure a broad diversification of credit risk. Established limits and actual levels of exposure are regularly reviewed by the

Chief Credit Officer and senior management. Credit policies and procedures are designed to identify, at an early stage, exposures which require more detailed monitoring and review. The Bank has implemented a credit risk rating system and a watchlist for this purpose. The Bank uses these together with the classification system in determining the appropriate level of specific and general provisions for credit losses.

The credit risk associated with foreign exchange and derivative products is assessed in a manner similar to that associated with on-balance sheet activities. However, unlike on-balance sheet exposures where the principal amount and interest generally represents the maximum credit exposure, the notional amount relating to a foreign exchange or derivative transaction typically exceeds the maximum possible credit loss by a substantial margin. The Bank's measure of credit exposure for foreign exchange and derivatives contracts is therefore more appropriately considered



Financial Review

continued

to be their replacement cost at current market rates, should the counterparty default prior to the settlement date. The gross positive market values or credit risk amounts of foreign exchange and derivative transactions are set out in Note 21 to the Financial Statements. The total credit risk amount in respect of all such transactions outstanding at the 1997 year end amounted to only \$66.5 million before taking account of the risk-reducing benefits of any collateral held or legally enforceable netting agreements. The note also highlights that 69.5 per cent of the total credit risk was concentrated on major OECD-based banks and was predominantly short-term in nature with 90.0 per cent of transactions outstanding at the end of 1997 due to mature within one year.

Market Risk

Market risk is the risk that the value of a financial instrument or a portfolio of financial instruments will change as a result of a change in market conditions. This risk arises from the Bank's trading, asset and liability management and investment activities in the interest rate, foreign exchange and equity markets. The Bank has a limit structure incorporating both VaR-based and non-VaR-based limits with respect to market risk. There are a variety of non-VaR-based constraints. These relate, inter alia, to positions, volumes, concentrations, maximum allowable losses and maturities. Exposures are monitored against the range of limits and regularly reported to, and reviewed by, senior management.

A key element in market risk management is the estimation of potential loss that may arise from adverse changes in market conditions. GIB utilises a Value-at-Risk system to estimate such losses. Value-at-Risk takes account of variables that may cause a change in portfolio value. These include interest rates, foreign

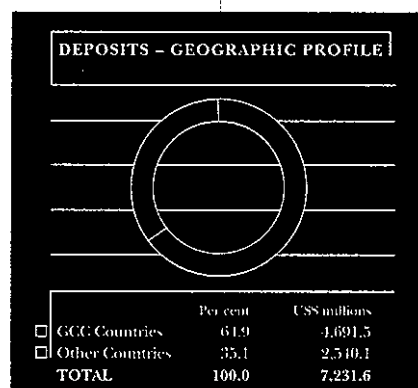
exchange rates, securities prices, their respective volatilities and the correlations between these variables. GIB uses exponentially weighted historical one-day movements in these variables from the RiskMetrics™ data set in estimating potential future losses from its trading and asset and liability activities as well as from its investment portfolios. These estimates assume normal market conditions and take account of potential diversification benefits of different positions

both within each and across different portfolios.

GIB measures losses that are anticipated to occur within a 95 per cent confidence level. This implies that there is a 5 per cent or 1 in 20 chance of a loss exceeding the VaR over the prescribed time horizon or holding period. A 1-day horizon is relevant for trading activities while a

longer horizon is more appropriate for both asset and liability management and investment activities. Since the substantial majority of GIB's exposure to market risk resides within its investment rather than its trading activity, VaR at the total bank level is consolidated utilising a 25-working day rather than a 1-day holding period.

The graph on page 24 sets out the total Value-at-Risk of all activities at the close of business each day throughout the year. The figures are calculated at the 5 per cent risk level (1.65 standard deviations) and at the 25-working day horizon based on the RiskMetrics™ monthly data set. On this basis VaR over the period averaged \$7.5 million and varied within the range of \$4.9 million to \$10.8 million. (At a 1-day rather than a 25-day horizon but at the same 5 per cent risk level average VaR was \$1.5 million and varied between \$1.0 million and \$2.2 million.) At the 1997 year end VaR at the 25-day horizon amounted to \$10.8 million. The risk profile presented in the financial statements was therefore reasonably typical of the average prevailing



Financial Review

continued

during the year under review.

A major objective of asset and liability management is the maximisation of net interest income through the proactive management of the asset and liability profile based on anticipated movements in interest rates. Nominal gap and VaR-based limits are utilised to control fluctuations in interest earnings resulting from changes in interest rate levels. The asset and liability repricing profile and details of the effective interest rates prevailing at the year end on the various asset and liability categories are set out in Note 20 to the Financial Statements. The repricing profiles of securities and loans incorporate the effect of interest rate swaps used to modify the interest rate characteristics of specific transactions.

By contrast interest rate swaps and forward rate agreements that have been used for asset and liability management purposes to hedge overall exposure to interest rate risk are included separately as Off-Balance Sheet Items. As illustrated in Note 20 the substantial majority of the Bank's assets and liabilities reprice within one year. The volume of net interest-bearing assets repricing over one year amounted to \$470.0 million or 4.9 per cent of Total Assets. This largely represented the fixed rate investment securities portfolio which had a modified duration of 2.25 at the year end.

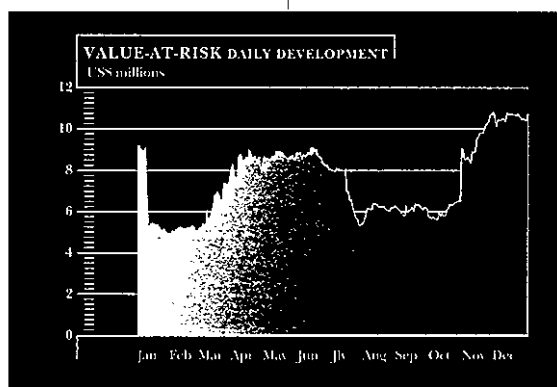
The Bank views VaR as an effective risk management tool and a valuable addition to the non-statistically based limit structure. It permits a consistent and uniform measure of market risk across all applicable products and activities based on the assumption of normal market conditions. The Bank therefore assumes market risk on a prudent basis in recognition of the fact that market shocks may result in losses in excess of those anticipated from VaR. A broad mix of

limits are thus employed. This notwithstanding GIB recognises that limits in themselves are an aid to – rather than a substitute for – sound judgement. The Bank recognises sound judgement as the cornerstone of effective market risk management.

Liquidity Risk and Funding

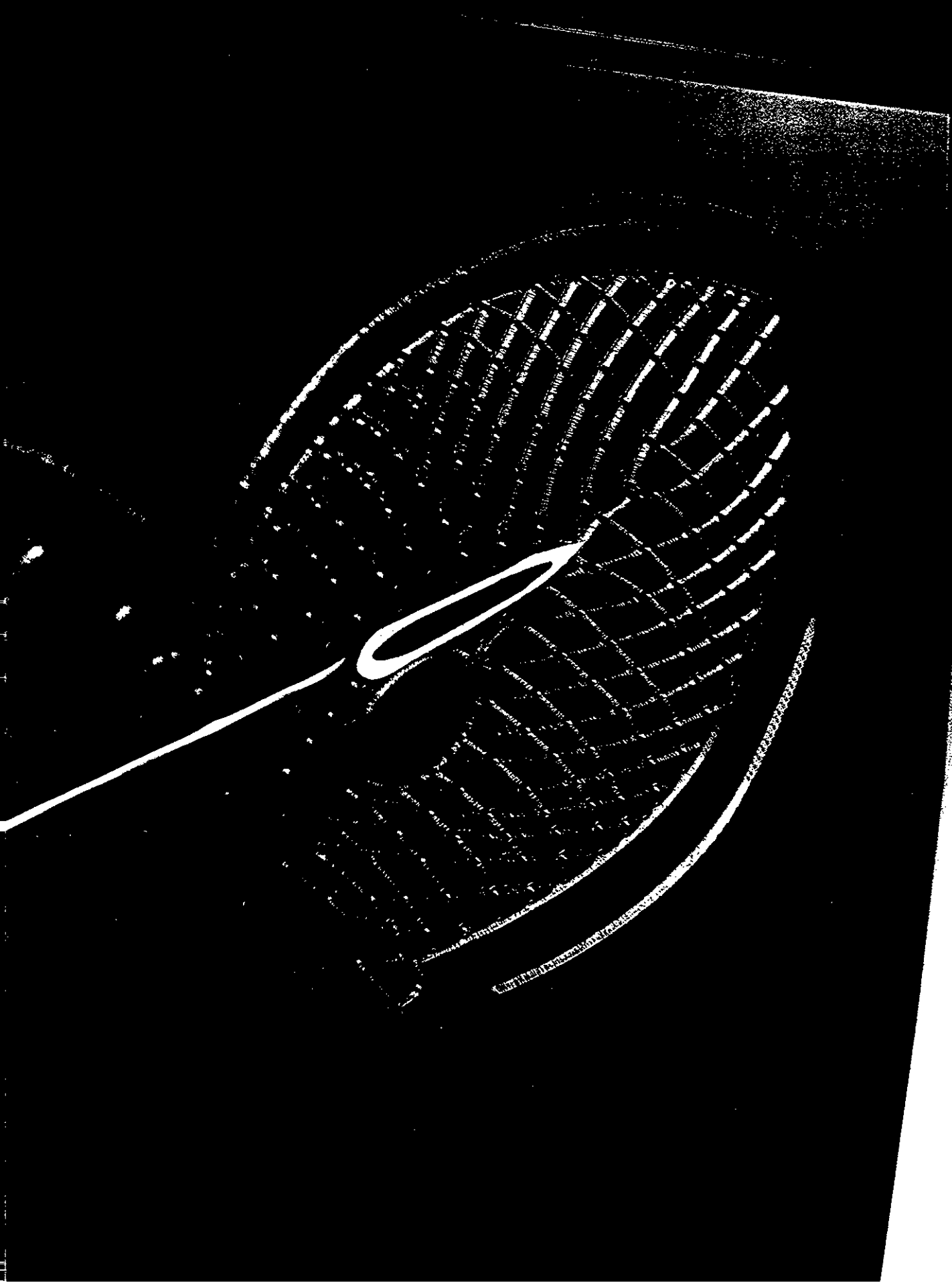
Liquidity risk management ensures that funds are available at all times to meet the funding requirements of the Bank.

GIB's liquidity management policies are designed to ensure that even under adverse conditions the Bank has access to adequate funds to meet its obligations. In normal conditions the objective is to ensure that there are sufficient funds available not only to



meet current commitments but also to provide the flexibility to expand when opportunities arise. These objectives are met through the application of a prudent mix of liquidity controls. These controls provide security of access to liquidity without undue exposure to increased costs from the liquidation of assets or the aggressive bidding for deposits. The liquidity controls ensure over the short term that 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 marketable assets and also an adequately diversified deposit base in terms of both maturities and range of counterparties. During the year under review the contractual maturity profile of the Bank's funding base was further enhanced through the issue of a \$200 million five-year floating rate note. This was the Bank's first floating rate note issue and increased total term financing to \$750 million at the 1997 year end. Deposits from Customers provide a further stable source of funding.

GIB possesses superior *skills* which are used to create innovative financial solutions.



Financial Review

continued

The asset and liability maturity profile by individual asset and liability category based on contractual repayment arrangements is set out in Note 19 to the Financial Statements. At the 1997 year end 35.3 per cent of Total Assets were due to mature within three months. A significant portion of assets with longer term maturities were readily realisable securities. With regard to deposits the Bank's retention records demonstrate that there is considerable divergence between their contractual and effective maturities. By way of example average deposits in 1997 from those counterparties with deposits over \$10 million at the 1997 year end amounted to \$6,104 million. Thus, these deposits of a core nature together with Shareholders' Equity and Term Financing were more than double and thus more than adequately funded the least liquid asset category, Loans and Advances. The loan portfolio is also comfortably exceeded by the more stable deposits from the GCC region. Deposits from GCC country governments and central banks and other institutions headquartered in the GCC states at 31st December 1997 amounted to \$4,691.5 million. GCC deposits to total loans cover was therefore 1.3 times. Total deposits and term financing coverage to loans was 2.3 times compared to the previous year's level of 2.2 while the liquid assets ratio, which expresses bank balances, money market instruments, placements with banks and securities as a percentage of total assets, improved year-on-year from 60.2 per cent to 61.6 per cent.

Operational Risk

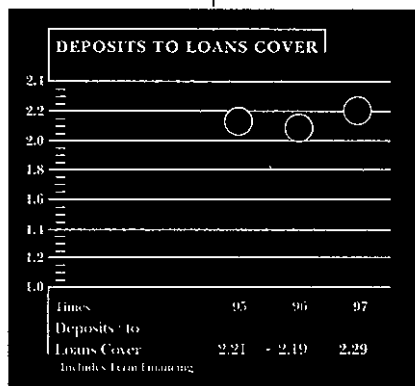
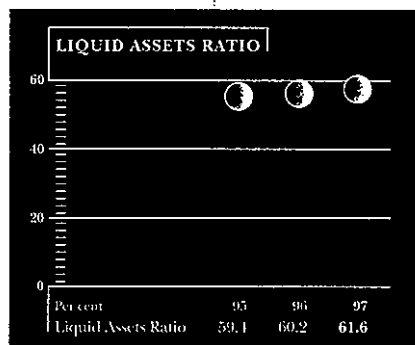
Operational risk is the potential for loss caused by human error, fraud or the failure to record, monitor or account for transactions and positions.

Operational risk is mitigated by a comprehensive system of internal controls. This includes systems and procedures to monitor transactions and positions, the confirmation of transactions, appropriate segregation of duties and periodic reviews by both internal and external auditors.

Of particular concern are the serious technical challenges faced by many of the world's computer systems in processing date related information beyond 1st January 2000. The Bank has already undertaken a Year 2000 compliance review of all in-house and third party developed computer software, hardware, information delivery services and communication systems. An action plan has been initiated to develop or acquire the required revisions to non-compliant systems. Full testing of all systems will take place in the second half of 1998 with the aim of achieving compliance of the Bank's in-house systems by 31st December 1998. In addition, a dialogue

continues to be maintained with customers, correspondents and counterparts as to the status of their own Year 2000 projects.

The Bank is also proactively considering and addressing the operational, accounting, legal and strategic risks associated with European Economic and Monetary Union (EMU) and in particular the introduction of the Euro.



Financial Statements

Accounting Philosophy

Gulf International Bank is committed to the ongoing enhancement of its financial reporting. The Bank's objective is to provide clear, comprehensive and relevant disclosure in order to facilitate financial appraisal and risk assessment. Accounting and reporting policies comply with the requirements of International Accounting Standards and conform with best practice in the banking industry.

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Auditors' Report to the Shareholders

We have audited the financial statements of Gulf International Bank B.S.C. as at, and for the year ended, 31st December 1997 as set out on pages 29 to 45.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

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

BASIS OF OPINION

We conducted our audit in accordance with the Bahrain Audit Law 26/1996 and in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion, the financial statements present fairly, in all material respects, the financial position of Gulf International Bank B.S.C. as at 31st December 1997, and the results of its operations and its cash flows for the year then ended, in accordance with International Accounting Standards and comply with the Bahrain Commercial Companies Law 1975 (as amended) and the Bahrain Monetary Agency Law 1973 (as amended).

OTHER REGULATORY MATTERS

In addition, in our opinion, the Bank has maintained proper accounting records and the financial statements are in agreement therewith. We have reviewed the accompanying Chairman's Statement and confirm that the information contained therein is consistent with the financial statements. To the best of our knowledge and belief, no violations of the Bahrain Commercial Companies Law 1975 (as amended), or the Bahrain Monetary Agency Law 1973 (as amended), or the terms of the Bank's licence or Agreement of Establishment and Articles of Association have occurred during the year that might have had a material adverse effect on the business of the Bank or on its financial position. Satisfactory explanations and information have been provided to us by management in response to all our requests.

KPMG

Public Accountants, Manama, Bahrain

18th February 1998

Balance Sheet

	Note	At 31.12.97 US\$ millions	At 31.12.96 US\$ millions
ASSETS			
Cash and Balances with Banks		85.9	53.4
Money Market Instruments	3	260.7	266.3
Placements with Banks	4	2,281.4	2,182.1
Trading Securities	5	192.1	86.2
Investment Securities	6	3,047.0	2,817.6
Loans and Advances	7	3,478.7	3,436.5
Fixed Assets	8	13.6	13.0
Other Assets		164.5	127.8
TOTAL ASSETS		9,523.9	8,982.9
LIABILITIES			
Deposits from Banks	9	4,456.8	4,130.8
Deposits from Customers	9	2,774.8	2,836.5
Securities Sold under Agreements to Repurchase		656.2	606.3
Proposed Dividend		45.0	45.0
Other Liabilities	10	147.2	161.8
Term Financing	11	750.0	550.0
TOTAL LIABILITIES		8,830.0	8,330.4
SHAREHOLDERS' EQUITY			
Share Capital	12	450.0	450.0
Reserves	13	243.9	202.5
SHAREHOLDERS' EQUITY		693.9	652.5
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY		9,523.9	8,982.9



Ibrahim Abdul-Karim
Chairman



Dr. Abdullah I. El-Kuwaiz
General Manager

The notes on pages 32 to 45 form part of these financial statements.

Statement of Income and Appropriations

	Note	Year Ended 31.12.97 US\$ millions	Year Ended 31.12.96 US\$ millions
INTEREST REVENUE			
Interest and Fees on Loans	14	257.7	237.8
Interest on Placements and Money Market Instruments		133.2	118.5
Interest on Securities		169.0	162.5
		559.9	518.8
INTEREST EXPENSE			
		450.3	408.5
NET INTEREST REVENUE			
		109.6	110.3
Provision for Loan Losses	7	(23.0)	(10.0)
Provision for Investment Securities	6	(7.0)	-
NET INTEREST REVENUE AFTER PROVISIONS			
		79.6	100.3
OTHER INCOME			
	15	54.0	38.8
NET INTEREST AND OTHER INCOME			
		133.6	139.1
OPERATING EXPENSES			
Staff	16	30.3	30.0
Premises		4.3	4.4
Other		12.1	9.9
		46.7	44.3
NET INCOME BEFORE TAX			
		86.9	94.8
Overseas Tax	17	(0.5)	(0.3)
NET INCOME AFTER TAX			
		86.4	94.5
APPROPRIATIONS			
Compulsory Reserve	13	8.6	9.4
Voluntary Reserve	13	8.6	9.4
Proposed Dividend		45.0	45.0
Retained Earnings	13	24.2	30.7
		86.4	94.5

The notes on pages 32 to 45 form part of these financial statements.

Statement of Cash Flows

	Year Ended 31.12.97 US\$ millions	Year Ended 31.12.96 US\$ millions
OPERATING ACTIVITIES		
Net Income	86.4	94.5
Adjustments to reconcile Net Income to Net Cash (Outflow)/Inflow from Operating Activities:		
Provision for Loan Losses	23.0	10.0
Provision for Investment Securities	7.0	—
Profit on Investment Securities	(9.4)	(12.7)
Profit on sale of Associated Company	(8.6)	—
Amortisation of Investment Securities	3.0	3.4
Depreciation of Fixed Assets	1.9	1.9
(Increase)/decrease in accrued interest receivable	(24.5)	22.5
Increase/(decrease) in accrued interest payable	9.5	(26.4)
(Increase)/decrease in other net assets	(36.3)	36.7
Net (increase)/decrease in Trading Securities	(105.9)	48.4
NET CASH (OUTFLOW)/INFLOW FROM OPERATING ACTIVITIES	(53.9)	178.3
INVESTING ACTIVITIES		
Net increase in Placements with Banks	(99.3)	(48.8)
Net increase in Loans and Advances	(65.2)	(188.1)
Purchase of Investment Securities	(1,259.4)	(1,216.3)
Sale and maturity of Investment Securities	1,010.3	794.1
Proceeds from sale of Associated Company	27.7	—
Purchase of Fixed Assets	(2.5)	(1.9)
NET CASH OUTFLOW FROM INVESTING ACTIVITIES	(388.4)	(661.0)
FINANCING ACTIVITIES		
Net increase/(decrease) in Deposits from Banks	326.0	(106.9)
Net (decrease)/increase in Deposits from Customers	(61.7)	183.2
Net increase in Securities Sold under Agreements to Repurchase	49.9	167.0
Increase in Term Financing	200.0	250.0
Dividends paid	(45.0)	(45.0)
NET CASH INFLOW FROM FINANCING ACTIVITIES	469.2	448.3
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	26.9	(34.4)
CASH AND CASH EQUIVALENTS AT 1ST JANUARY	319.7	354.1
CASH AND CASH EQUIVALENTS AT 31ST DECEMBER	346.6	319.7

Cash and Cash Equivalents comprise Cash and Balances with Banks and Money Market Instruments. Movements in Trading Securities and Loans and Advances are stated net of transfers in respect of bonds received in settlement of sovereign debt principal claims.

The notes on pages 32 to 45 form part of these financial statements.

Notes to the Financial Statements

For the Year Ended 31st December 1997

1. INCORPORATION AND REGISTRATION

Gulf International Bank B.S.C. ("the Bank") is a Bahraini Shareholding Company incorporated in the State of Bahrain by Amiri Decree Law No. 30 dated 24th November 1975 and is registered as an offshore banking unit with the Bahrain Monetary Agency.

The Bank is wholly owned by Gulf Investment Corporation G.S.C. ("GIC"), an international investment company registered in the State of Kuwait and owned equally by the governments of the six member states of the Gulf Cooperation Council ("GCC") – Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates.

The Bank is principally engaged in the provision of wholesale banking services.

2. ACCOUNTING POLICIES

The accounting and reporting policies of the Bank comply with International Accounting Standards and conform with prevailing practices within the banking industry.

The following is a description of the more significant accounting policies adopted by the Bank:

2.1 Accounting Convention

The financial statements have been prepared under the historical cost convention.

2.2 Money Market Instruments

Money Market Instruments are stated at cost, adjusted for the amortisation of premiums and accretion of discounts.

2.3 Securities

Trading Securities and Securities Sold but not yet Purchased are stated at market value. Realised and unrealised profits and losses are included in Other Income. Securities Sold but not yet Purchased are included in Other Liabilities.

Investment Securities are stated at cost, adjusted for the amortisation of premiums and accretion of discounts, less provisions for credit losses.

Bonds received in settlement of sovereign debt interest and principal claims are capitalised at the same net book value as other debt obligations of that country. The capitalised amount of bonds received in settlement of interest claims is credited to Interest and Fees on Loans.

2.4 Securities Financing Arrangements

Securities Purchased under Agreements to Resell (resale agreements) and Securities Sold under Agreements to Repurchase (repurchase agreements) are treated as collateralised lending and borrowing transactions and are stated at the amounts lent or borrowed. Securities Purchased under Agreements to Resell are included in Money Market Instruments.

2.5 Subsidiaries and Associated Companies

Investments in subsidiary companies are not material to the financial statements and are accordingly stated at cost less provision for permanent diminution in value. Investments in associated companies which are intended to be held for the long term are accounted for by the equity method. The Bank's share of the retained earnings of associated companies is determined with reference to the most recent audited financial statements and the latest unaudited financial information available to shareholders. Investments in associated companies which are not intended to be held for the long term are stated at cost less provision for permanent diminution in value.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

2. ACCOUNTING POLICIES *continued*

2.6 *Loans and Advances*

Loans and Advances are stated net of provisions for credit losses.

Loans on which interest or principal is 90 days or more overdue are placed on a non-accrual basis and all unpaid and accrued interest is reversed from income. Interest on non-accrual loans is included in income only when received. Loans are restored to accrual status only after all delinquent interest and principal payments have been brought current, a regular payment performance has been established and future payments are reasonably assured.

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

2.7 *Provisions for Credit Losses*

Provisions for credit losses comprise both specific and general provisions. Specific provisions are maintained to cover identified potential losses and permanent diminution in the value of investments. Specific provisions in respect of troubled sovereign exposures are determined with reference to matrices of the relevant regulatory authorities. Specific provisions in respect of other credit exposures are made to the full extent of the estimated potential loss or permanent diminution in value. General provisions are maintained to cover possible losses which as yet have not been identified. Provisions for credit losses are deducted from the relevant asset category.

2.8 *Fixed Assets*

Land is stated at cost. Other fixed assets are stated at cost less accumulated depreciation. Depreciation is computed on a straight line basis over the estimated useful life of each asset category as follows:

Buildings	- Ten years
Installations	- Four years or period of lease if longer
Office Furniture	- Six years
Office Equipment	- Four years
Motor Vehicles	- Three years

2.9 *Foreign Currency Conversion*

Assets and liabilities denominated in foreign currencies are converted into US Dollars at market rates of exchange prevailing on the balance sheet date. Realised and unrealised foreign exchange profits and losses are included in Other Income.

2.10 *Off-Balance Sheet Derivative and Foreign Exchange Instruments*

Off-balance sheet financial instruments include futures, forwards, swaps and options in the interest rate and foreign exchange markets. The Bank utilises these instruments to satisfy the requirements of its customers, for proprietary trading purposes and to hedge its own exposure to interest rate and currency risk.

Those instruments entered into for trading purposes or to hedge other trading positions are marked-to-market with associated profits and losses included in Other Income.

Profits and losses on instruments entered into for hedging purposes, other than those referred to above, are recognised in Interest Revenue or Interest Expense on an amortisation basis over the lives of the hedged assets or liabilities.

2.11 *Retirement and Other Terminal Benefits*

Retirement and other terminal benefits are accrued for during the employees' period of service in accordance with contractual obligations and regulations applicable in each location.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

3. MONEY MARKET INSTRUMENTS

Money Market Instruments at 31st December 1997 included US and German government Treasury bills and Securities Purchased under Agreements to Resell amounting to US\$201.2 million and US\$5.0 million respectively (1996: US\$211.4 million and US\$35.0 million respectively).

4. PLACEMENTS WITH BANKS

Placements with Banks at 31st December 1997 included placements with non-bank financial institutions amounting to US\$53.9 million (1996: US\$150.3 million).

5. TRADING SECURITIES

The classification of Trading Securities was as follows:

	31.12.97 US\$ millions	31.12.96 US\$ millions
Listed debt securities	110.2	78.1
Managed funds	75.7	—
Equities	6.2	8.1
	<u>192.1</u>	<u>86.2</u>

The externally managed funds provide a diversified exposure to foreign exchange and international debt markets.

6. INVESTMENT SECURITIES

a) Classification of Investment Securities

	31.12.97		31.12.96	
	Book Value US\$ millions	Market Value US\$ millions	Book Value US\$ millions	Market Value US\$ millions
AAA/Aaa rated debt securities	858.8	866.0	962.8	980.3
Debt securities of other investment grade issuers	1,629.4	1,644.9	1,390.9	1,415.6
Other debt securities	349.5	358.0	307.2	316.1
Equities and equity funds	209.3	208.6	156.7	163.0
	<u>3,047.0</u>	<u>3,077.5</u>	<u>2,817.6</u>	<u>2,875.0</u>

The market value of Investment Securities at 31st December 1997 included net unrealised gains on securities of US\$39.3 million (1996: US\$72.4 million) and net unrealised losses of US\$8.8 million (1996: US\$15.0 million) on interest rate swaps used to convert fixed rate securities to a floating rate basis.

Equities and equity funds at 31st December 1997 included investments in subsidiaries and associated companies of US\$6.2 million (1996: US\$17.6 million). During 1997 the Bank sold its 49 per cent investment in GIBCorp Oman LLC. The profit realised on the sale is set out in Note 15.

b) Provisions for Investment Securities

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

	1997			1996		
	Specific US\$ millions	General US\$ millions	Total US\$ millions	Specific US\$ millions	General US\$ millions	Total US\$ millions
At 1st January	9.6	21.0	30.6	7.7	22.9	30.6
Charge/(Credit) for the year	6.3	0.7	7.0	1.9	(1.9)	—
At 31st December	<u>15.9</u>	<u>21.7</u>	<u>37.6</u>	<u>9.6</u>	<u>21.0</u>	<u>30.6</u>

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

7. LOANS AND ADVANCES

	31.12.97 US\$ millions	31.12.96 US\$ millions
Gross Loans and Advances	4,268.3	4,228.8
Provisions for Loan Losses	(789.6)	(792.3)
Net Loans and Advances	3,478.7	3,436.5

a) Concentrations of Loans and Advances

Net Loans and Advances at 31st December 1997 included exposure to GCC country governments of US\$465.4 million (1996: US\$544.6 million) and OECD country central government and agency risk of US\$258.7 million (1996: US\$429.2 million).

There were no significant concentrations by industrial sector at 31st December 1997 and at 31st December 1996.

b) Provisions for Loan Losses

The movements in the provisions for loan losses were as follows:

	Specific US\$ millions	1997 General US\$ millions	Total US\$ millions	Specific US\$ millions	1996 General US\$ millions	Total US\$ millions
At 1st January	623.2	169.1	792.3	652.9	159.6	812.5
Exchange rate movements	(16.3)	—	(16.3)	(13.9)	—	(13.9)
Amounts utilised	(9.4)	—	(9.4)	(16.3)	—	(16.3)
Charge for the year	18.0	5.0	23.0	0.5	9.5	10.0
At 31st December	615.5	174.1	789.6	623.2	169.1	792.3

c) Non-Performing Loans

The gross and net book values of loans on which interest was not being accrued were as follows:

	31.12.97		31.12.96	
	Gross US\$ millions	Net Book Value US\$ millions	Gross US\$ millions	Net Book Value US\$ millions
Sovereign	479.5	19.3	509.9	9.9
Corporate	36.8	4.7	41.4	13.1
	516.3	24.0	551.3	23.0

8. FIXED ASSETS

	Freehold Land US\$ millions	Buildings US\$ millions	Premises and Equipment US\$ millions	Total US\$ millions
At 31st December 1997				
Cost	8.9	26.8	18.8	54.5
Accumulated Depreciation	—	26.0	14.9	40.9
Net Book Value	8.9	0.8	3.9	13.6
At 31st December 1996				
Net Book Value	8.9	0.8	3.3	13.0

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

9. DEPOSITS

Of total deposits at 31st December 1997 amounting to US\$7,231.6 million (1996: US\$6,967.3 million), US\$4,691.5 million (1996: US\$4,722.6 million) were from GCC country governments and central banks and other institutions headquartered in the GCC states. Deposits from central banks are included in Deposits from Customers.

10. OTHER LIABILITIES

Other Liabilities at 31st December 1997 included Securities Sold but not yet Purchased amounting to US\$2.1 million (1996: US\$34.6 million).

11. TERM FINANCING

	31.12.97 US\$ millions	31.12.96 US\$ millions
US\$ Floating rate loan due in 2000	300.0	300.0
US\$ Floating rate loan due between 2001 and 2003	250.0	250.0
US\$ Floating rate note due in 2002	200.0	—
	<u>750.0</u>	<u>550.0</u>

12. SHARE CAPITAL

	31.12.97 US\$ millions	31.12.96 US\$ millions
Authorised, Issued and Fully Paid	<u>450.0</u>	<u>450.0</u>

The Issued Share Capital at 31st December 1997 and 31st December 1996 comprised 450 million shares of US\$1 each.

13. RESERVES

	1997			1996	
	Compulsory Reserve US\$ millions	Voluntary Reserve US\$ millions	Retained Earnings US\$ millions	Total US\$ millions	Total US\$ millions
At 1st January	45.7	45.7	111.1	202.5	153.0
Transfer from Statement of Income and Appropriations	8.6	8.6	24.2	41.4	49.5
At 31st December	<u>54.3</u>	<u>54.3</u>	<u>135.3</u>	<u>243.9</u>	<u>202.5</u>

Under the provisions of Article 52 of the Bank's Articles of Association 10 per cent of net profits are to be transferred to each of the Compulsory and Voluntary Reserves.

14. INTEREST AND FEES ON LOANS

Interest and Fees on Loans included US\$2.9 million (1996: US\$0.5 million) representing the net book value of bonds received in settlement of sovereign debt interest claims.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

15. OTHER INCOME

	1997 US\$ millions	1996 US\$ millions
Profit on Trading Securities	14.3	4.1
Profit on Investment Securities	9.4	12.7
Profit on sale of Associated Company	8.6	—
Dividend Income	8.5	8.6
Commissions on Letters of Credit and Guarantee	7.2	7.2
Profit on Foreign Exchange	5.3	4.4
Fee and Sundry Income	0.7	1.2
Share of Profits of Associated Companies	—	0.6
	<u>54.0</u>	<u>38.8</u>

16. RETIREMENT AND OTHER TERMINAL BENEFITS

The Bank has defined contribution pension plans which cover 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 Bank also pays contributions to Government defined contribution pension plans in accordance with the legal requirements in each location.

The total cost of retirement and other terminal benefits included in Staff Expenses for the year ended 31st December 1997 amounted to US\$3.7 million (1996: US\$3.4 million).

17. OVERSEAS TAX

Provision for overseas taxation is included in Other Liabilities and represents the tax charge for the year on overseas branch activities.

18. GEOGRAPHIC DISTRIBUTION OF RISK ASSETS

	31.12.97				31.12.96	
	Placements & Balances with Banks	Securities & Money Market Instruments	Loans and Advances	Credit-related Contingent Items	Total	Total
	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions	US\$ millions
GCC	551.8	222.0	1,682.1	1,054.3	3,510.2	3,035.1
Other Middle East & North Africa	126.3	85.2	181.8	139.8	533.1	359.7
Europe	535.6	1,584.4	498.6	691.8	3,310.4	3,153.0
North America	392.2	1,285.8	363.4	1,054.9	3,096.3	2,909.9
Japan & Other Asia	761.4	275.0	683.4	231.8	1,951.6	1,881.0
Latin America	—	47.4	69.4	—	116.8	60.9
Total	<u>2,367.3</u>	<u>3,499.8</u>	<u>3,478.7</u>	<u>3,172.6</u>	<u>12,518.4</u>	<u>11,399.6</u>

An analysis of derivatives and foreign exchange products is set out in Note 21(a).

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

19. MATURITIES OF ASSETS AND LIABILITIES

The asset and liability maturity profile was as follows:

	Within 3 months US\$ millions	Month 4 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
<i>At 31st December 1997</i>						
Money Market Instruments	214.2	46.5	—	—	—	260.7
Placements & Balances with Banks	1,753.9	613.4	—	—	—	2,367.3
Securities	222.9	441.0	799.5	642.5	1,133.2	3,239.1
Loans and Advances	1,050.4	791.9	820.1	476.4	339.9	3,478.7
Fixed & Other Assets	119.4	45.1	—	—	13.6	178.1
Total Assets	3,360.8	1,937.9	1,619.6	1,118.9	1,486.7	9,523.9
Deposits	6,083.1	1,028.5	120.0	—	—	7,231.6
Securities Sold under Agreements to Repurchase	656.2	—	—	—	—	656.2
Proposed Dividend & Other Liabilities	127.1	65.1	—	—	—	192.2
Term Financing	—	—	300.0	400.0	50.0	750.0
Shareholders' Equity	—	—	—	—	693.9	693.9
Liabilities & Shareholders' Equity	6,866.4	1,093.6	420.0	400.0	743.9	9,523.9
<i>At 31st December 1996</i>						
Total Assets	3,663.5	1,294.1	1,635.4	1,261.4	1,128.5	8,982.9
Liabilities & Shareholders' Equity	6,628.8	1,097.9	53.7	400.0	802.5	8,982.9

The asset and liability maturities are based on contractual repayment arrangements and as such do not take account of the effective maturities of deposits as indicated by the Bank's deposit retention records. Counterparties each with deposits over US\$10 million at 31st December 1997 had average deposits throughout 1997 amounting to US\$6,104 million (1996: US\$5,706 million). Formal liquidity controls are nevertheless based on contractual liability maturities.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

20. INTEREST RATE RISK

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

	Within 3 months US\$ millions	Months 4 to 6 US\$ millions	Months 7 to 12 US\$ millions	Over 1 year US\$ millions	Non-interest bearing items US\$ millions	Total US\$ millions	Effective Interest Rates %
<i>At 31st December 1997</i>							
Money Market Instruments	214.2	13.2	33.3	—	—	260.7	4.34
Placements & Balances							
with Banks	1,753.9	466.0	147.4	—	—	2,367.3	5.66
Trading Securities	110.2	—	—	—	81.9	192.1	4.26
Investment Securities:							
— Fixed rate	—	—	178.2	464.2	—	642.4	5.53
— Floating rate	1,861.6	347.4	8.0	—	(21.7)	2,195.3	6.33
— Equities & Equity Funds	—	—	—	—	209.3	209.3	—
Loans and Advances	2,425.1	1,058.7	163.2	5.8	(174.1)	3,478.7	7.24
Fixed & Other Assets	—	—	—	—	178.1	178.1	—
Total Assets	6,365.0	1,885.3	530.1	470.0	273.5	9,523.9	
Deposits	6,203.1	696.0	332.5	—	—	7,231.6	5.49
Securities Sold under							
Agreements to Repurchase	656.2	—	—	—	—	656.2	4.43
Proposed Dividend &							
Other Liabilities	—	—	—	—	192.2	192.2	—
Term Financing	750.0	—	—	—	—	750.0	6.31
Shareholders' Equity	—	—	—	—	693.9	693.9	—
Liabilities & Shareholders'							
Equity	7,609.3	696.0	332.5	—	886.1	9,523.9	
Balance Sheet Items	(1,244.3)	1,189.3	197.6	470.0	(612.6)	—	
Off-Balance Sheet Items	157.1	(425.3)	268.2	—	—	—	
Interest Rate Sensitivity Gap	(1,087.2)	764.0	465.8	470.0	(612.6)	—	
Cumulative Interest Rate							
Sensitivity Gap	(1,087.2)	(323.2)	142.6	612.6	—	—	
<i>At 31st December 1996</i>							
Cumulative Interest Rate							
Sensitivity Gap	(396.7)	35.7	135.6	722.8	—	—	

The repricing profile is based on the remaining period to the next interest repricing date. The repricing profiles of securities and loans incorporate the effect of interest rate swaps used to modify the interest rate characteristics of specific transactions. Interest rate swaps and forward rate agreements that have been used for asset and liability management purposes to hedge overall exposure to interest rate risk are included separately as Off-Balance Sheet Items. Their impact on effective interest rates is reflected in Deposits. The general provisions for security and loan losses are deducted from non-interest bearing assets.

The substantial majority of the Bank's assets and liabilities reprice within one year. Accordingly there is a limited exposure to interest rate risk. The fixed rate investment securities portfolio is the principal asset or liability category to reprice over one year. At 31st December 1997 the modified duration of this portfolio was 2.25 (1996: 3.70). 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 portfolio was US\$149,000 (1996: US\$224,000).

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

21. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS

a) Derivatives and Foreign Exchange Products

The Bank utilises derivatives 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 interest rate and currency risk. The Bank has appropriate Board-approved procedures for the control of exposure to both market and credit risk from its derivatives 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 derivatives and foreign exchange markets, it is neither a measure of market nor credit risk. The Bank'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 transactions before taking account of any collateral held or any master netting agreements in place.

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

PRODUCT ANALYSIS

At 31st December 1997

Foreign Exchange Contracts:

	Trading US\$ millions	Notional Amounts ALM US\$ millions	Total US\$ millions	Credit Risk Amounts US\$ millions
Unmatured spot, forward and futures contracts	4,647.3	1,176.2	5,823.5	47.7
Options purchased	35.2	—	35.2	0.3
Options written	14.7	—	14.7	—
Total	4,697.2	1,176.2	5,873.4	48.0

Interest Rate Contracts:

Futures and forward rate agreements	272.9	684.3	957.2	0.1
Interest rate swaps	523.8	1,534.9	2,058.7	17.9
Options, Caps and Floors purchased	575.0	5.0	580.0	0.5
Options, Caps and Floors written	855.6	5.0	860.6	—
Total	2,227.3	2,229.2	4,456.5	18.5
Total	6,924.5	3,405.4	10,329.9	66.5

At 31st December 1996

Total	10,861.7	3,186.2	14,047.9	70.4
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Interest rate options purchased are exchange traded and therefore not subject to credit risk. There is no credit risk in respect of options, caps and floors written as they represent obligations of the Bank.

COUNTERPARTY ANALYSIS

	31.12.97		31.12.96	
	Banks US\$ millions	Other US\$ millions	Total US\$ millions	Total US\$ millions
Credit Risk Amounts				
OECD countries	46.2	2.8	49.0	43.0
GCC countries	1.3	16.0	17.3	27.4
Other countries	0.2	—	0.2	—
Total	47.7	18.8	66.5	70.4

Credit risk is concentrated on major OECD-based banks.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

21. OFF-BALANCE SHEET FINANCIAL INSTRUMENTS *continued*

MATURITY ANALYSIS

Notional Amounts	Year 1	Years	Years	Over	Total
	US\$ millions	2 & 3 US\$ millions	4 & 5 US\$ millions	5 years US\$ millions	US\$ millions
<i>At 31st December 1997</i>					
Foreign Exchange contracts	5,785.6	77.8	—	10.0	5,873.4
Interest Rate contracts	3,510.2	437.9	313.0	195.4	4,456.5
Total	9,295.8	515.7	313.0	205.4	10,329.9
<i>At 31st December 1996</i>					
Total	12,806.4	876.3	209.6	155.6	14,047.9

The Bank's derivatives and foreign exchange activities are predominantly short-term in nature. Transactions with maturities over one year either represent hedging transactions entered into for the Bank's own asset and liability management purposes or fully offset customer transactions.

SIGNIFICANT NET OPEN POSITIONS

At 31st December 1997 the Bank had a US\$25.4 million long (1996: US\$44.0 million long) Omani Riyal net open currency position. This related to Omani government investment security holdings.

There were no other significant derivative trading or foreign currency net open positions at 31st December 1997 and at 31st December 1996.

b) 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 the Bank's 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 exposure calculated in accordance with the capital adequacy guidelines of the Basle Committee on Banking Supervision.

	31.12.97		31.12.96	
	Notional Principal Amount US\$ millions	Risk- Weighted Exposure US\$ millions	Notional Principal Amount US\$ millions	Risk- Weighted Exposure US\$ millions
Direct credit substitutes	1.1	1.1	—	—
Transaction-related contingent items	1,146.5	493.7	1,055.6	462.5
Short-term self-liquidating trade-related contingent items	212.9	41.7	248.7	47.9
Undrawn loan commitments and underwriting commitments under note issuance and revolving facilities	1,812.1	507.8	1,253.2	434.9
Total	3,172.6	1,044.3	2,557.5	945.3

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

22. CAPITAL ADEQUACY

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

<i>Capital Base</i>	31.12.97 US\$ millions	31.12.96 US\$ millions
Tier I Capital		
Shareholders' Equity	693.9	652.5
Tier II Capital		
General provision subject to 1.25% risk-weighted exposure limitation	80.9	78.3
Total Capital Base	(a) 774.8	730.8
<i>Risk-Weighted Exposure</i>		
	31.12.97	31.12.96
	Notional Principal Amount US\$ millions	Risk-Weighted Exposure US\$ millions
	Notional Principal Amount US\$ millions	Risk-Weighted Exposure US\$ millions
Balance Sheet Items:		
Money Market Instruments	260.7	11.9
Placements & Balances with Banks	2,367.3	537.3
Securities	3,239.1	1,846.7
Loans and Advances	3,478.7	2,573.9
Fixed & Other Assets	178.1	109.9
	9,523.9	5,079.7
Off-Balance Sheet Items:		
Credit-related Contingent Items	3,172.6	1,044.3
Foreign Exchange Transactions	5,873.4	19.5
Interest Rate-related Items	4,456.5	5.9
	13,502.5	1,069.7
Credit Risk-weighted Exposure	6,149.4	6,192.6
<i>Market Risk</i>		
Market Risk-weighted Exposure	326.0	71.2
Total Risk-weighted Exposure	(b) 6,475.4	6,263.8
Risk Asset Ratio [(a)/(b) x 100]	12.0%	11.7%

Exposure to market risk is computed utilising a Value-at-Risk model in accordance with the provisions of the Amendment to the Capital Accord to Incorporate Market Risks issued by the Basle Committee in January 1996. Value-at-Risk is calculated based on a 99 per cent confidence level, a ten-day holding period, a twelve-month historical observation period of unweighted data from the RiskMetrics™ regulatory data set and a multiplication factor of three. Correlations across broad risk categories are excluded. Prescribed additions in respect of specific risk are made to general market risk computed by the model where required. The measure of market risk so found is multiplied by 12.5, the reciprocal of the 8 per cent minimum capital ratio, to give Market Risk-weighted Exposure on a basis consistent with Credit Risk-weighted Exposure.

With regard to credit risk the risk-weighted exposures for foreign exchange transactions and interest rate-related items are determined using the current exposure method. A credit conversion factor as determined by the Basle Committee is applied to the replacement cost of these contracts. The resultant amounts are then risk-weighted according to the classification of the counterparty.

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

23. RELATED PARTY TRANSACTIONS

During the year certain transactions were conducted with the Bank's parent company, Gulf Investment Corporation. These comprised standard wholesale money market and foreign exchange transactions that were conducted on an arm's length basis at open market prices.

	1997 US\$ millions	1996 US\$ millions
The following transactions were outstanding at 31st December of each year:		
Placements with GIC	28.0	115.3
Deposits from GIC	14.0	41.3
Floating rate notes held by GIC	10.0	—
Forward foreign exchange transactions	—	5.3
Interest on transactions during the year was as follows:		
Interest on Placements with GIC	2.6	1.4
Interest on Deposits from GIC	1.9	2.5
Interest on Floating rate notes held by GIC	0.3	—

24. EARNINGS PER SHARE

	1997 US\$ millions	1996 US\$ millions
Net Income after Tax (US\$ millions)	86.4	94.5
Weighted average number of shares in issue (millions)	450.0	450.0
Earnings per share	US\$0.19	US\$0.21

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

25. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

	Book Value US\$ millions	Fair Value US\$ millions	Excess over Book Value US\$ millions
<i>At 31st December 1997</i>			
Assets			
Cash and Balances with Banks	85.9	85.9	—
Money Market Instruments	260.7	260.7	—
Placements with Banks	2,281.4	2,281.4	—
Trading Securities	192.1	192.1	—
Investment Securities	3,047.0	3,077.5	30.5
Loans and Advances	3,478.7	3,547.8	69.1
Other Assets	164.5	164.5	—
Liabilities			
Deposits	7,231.6	7,231.6	—
Securities Sold under Agreements to Repurchase	656.2	656.2	—
Other Liabilities	147.2	147.2	—
Term Financing	750.0	750.0	—
Off-Balance Sheet Financial Instruments	—	—	—
Excess of Net Fair Values over Net Book Values			99.6
<i>At 31st December 1996</i>			
Excess of Net Fair Values over Net Book Values			139.4

Notes to the Financial Statements

For the Year Ended 31st December 1997
continued

25. FAIR VALUE OF FINANCIAL INSTRUMENTS *continued*

Based on the valuation methodology outlined below, the net fair values of all on-and off-balance sheet financial instruments exceeded their net book values at 31st December 1997 by US\$99.6 million (1996: US\$139.4 million).

a) Securities

The fair value of securities was based on quoted market prices with the exception of investments in subsidiaries and associated companies and unquoted equity investments, the fair values of which were estimated at book value.

b) Loans and Advances

The fair value of floating rate loans was principally estimated at book value less attributable specific provisions and the general provision for loan losses. The fair value of troubled sovereign debt was based on market bid prices. The fair value of fixed rate loans was estimated on a discounted cash flow basis utilising discount rates equal to prevailing market rates of interest in the respective currencies for loans of similar residual maturity and credit quality. The repricing profile of Loans and Advances is set out in Note 20. All but US\$5.8 million (1996: US\$3.2 million) of Loans and Advances reprice within one year.

c) Term Financing

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

d) Other On-Balance Sheet Financial Instruments

The fair values of all other on-balance sheet financial instruments approximated their respective book values due to their short-term nature.

e) Off-Balance Sheet Financial Instruments

Derivative instruments utilised for asset and liability management (ALM) purposes were valued based on market prices and incorporated in the fair values of Securities, Loans and Advances and Deposits. The net unrealised loss on these contracts at 31st December 1997 amounted to US\$10.9 million (1996: US\$15.3 million).

The fair values of derivative trading and foreign exchange instruments were based on market prices. The market values of derivative trading and foreign exchange instruments are included in the book values of Other Assets and Other Liabilities.

No fair value adjustment was made with respect to 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 materially reflect contractual fees and commissions actually charged at the balance sheet date for agreements of similar credit standing and maturity. Specific provisions have been made in respect of individual transactions, where a potential for loss has been identified. Such provisions are included in provisions for loan losses.

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Executive Vice President

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Senior Vice President

Human Resources Division:

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Senior Vice President

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to the Board

Adviser to Management:

Hussain Al-Ansari
Senior Vice President

MIDDLE EAST MARKETING AREA:

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Executive Vice President

Corporate & Multinational Banking Division:

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Near East Division:

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Senior Vice President

OPERATIONS & ADMINISTRATION GROUP:

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